



# 2008 Publication 4491

## Student Training Guide

For Use in Preparing Tax Year 2008 Returns

- Volunteer Income Tax Assistance (VITA)
- Tax Counseling for the Elderly (TCE)



Department of the Treasury  
Internal Revenue Service

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## Technical Updates

Tax law changes implemented after this product was published may cause various forms, tables, and worksheets to change. The supplemental changes (if any) are normally available in mid-December on [www.irs.gov](http://www.irs.gov) (keyword: Community Network).

Technical updates are also conveyed in Volunteer Quality Alerts during the filing season on [www.irs.gov](http://www.irs.gov). Also, consult your course instructor and/or site coordinator.

Department of the Treasury – Internal Revenue Service

## **Volunteer Agreement**

### **Standards of Conduct – VITA/TCE Programs**

The mission of the VITA/TCE Program is to provide free basic tax return preparation for eligible taxpayers. Volunteers are the program's most valuable resource. To establish the greatest degree of public trust, Volunteers have a responsibility to provide high quality service and uphold the highest of ethical standards.

As a participant in the VITA/TCE Program, I agree to the following standards of conduct:

- I will treat all taxpayers professionally, with courtesy and respect.
- I will safeguard the confidentiality of taxpayer information.
- I will apply the tax laws equitably and accurately to the best of my ability.
- I will only prepare returns for which I am certified. (Basic, Advanced, etc.)
- I will exercise reasonable care in the use and protection of equipment and supplies.
- I will not solicit business from taxpayers I assist or use the knowledge I have gained about them for any direct or indirect personal benefit for me or any other specific individual.
- I will not accept payment from taxpayers for the services I provide. I may receive compensation as an employee of a program sponsor.

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## **Confidentiality Statement**

All tax information received from taxpayers in your volunteer capacity is strictly confidential and should not, under any circumstances, be disclosed to unauthorized individuals and should be properly safeguarded.

All persons, scenarios and addresses appearing in this product are fictitious. Any resemblance to persons living or dead is purely coincidental.



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

WAGE AND INVESTMENT DIVISION

November 17, 2008

Welcome Volunteers!

Have you heard? Over 3 million tax returns were filed through the volunteer return preparation programs during the 2008 filing season. That was a phenomenal increase over the previous year and our accuracy rate was the best ever. The good news does not stop there. Last year, we told you Process Based Training (PBT) is coming. This year, **PBT is here!**

After three years of piloting, positive feedback, and suggestions for improvement from national and local volunteer organizations, we've learned PBT is the way to go. Many of you played an important role in getting us to this milestone, and I hope you share my excitement and enthusiasm as we implement PBT throughout the country.

PBT is a performance based curriculum. In addition to assisting you in understanding tax law, PBT will also provide more extensive opportunities for you to apply tax law by teaching you how to use the available return preparation tools (reference materials, intake and interview materials and the return preparation software).

This year, along with PBT, we are launching the Electronic Tax Software Practice Lab on Link & Learn Taxes on IRS.gov. This new feature on our e-learning application provides you an opportunity to gain practical experience using our tax year 2008 return preparation software—the same software you will use at your tax preparation site. As your training progresses, I'm sure you will embrace this new training approach and your learning experience on Link & Learn Taxes.

Before closing, let me remind you that the information you receive in your volunteer capacity is strictly confidential. Your instructor and Site Coordinator will provide additional guidance on maintaining the confidentiality and privacy of the information you receive from the taxpayers you serve. I welcome your suggestions and ideas for enhancing these materials and your overall training experience. Your instructor will accept your feedback on the form in your training kit or you may provide comments by mail to the following address:

Internal Revenue Service  
Stop 45-WI – VITA/TCE Training  
401 West Peachtree St., NW  
Atlanta, GA 30308

Thanks to each of you for volunteering your time and expertise. Enjoy your class!

Sincerely,

A handwritten signature in black ink, appearing to read "Julie Garcia", followed by a long horizontal line.

Julie Garcia  
Director, Stakeholder Partnerships, Education &  
Communication

## Notes

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## **Appendix B: Vanessa's Tax Documents**

### Important Tax Law Changes for 2008

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#### Recovery Rebate Credit

Individuals who did not receive an economic stimulus payment based on their 2007 return, or received a reduced payment amount, may be eligible for a recovery rebate credit on their 2008 return.

#### Standard Deduction Amount Increased

The standard deduction for most taxpayers who do not itemize deductions on Schedule A (Form 1040) has increased:

- \$10,900 - Married Filing Jointly or Qualifying Widow(er)
- \$8,000 - Head of Household
- \$5,450 - Single or Married Filing Separately

#### Limits Increased for Itemized Deductions

Taxpayers with an adjusted gross income above a certain amount may lose part of their itemized deductions. In 2008, this amount is increased to \$159,950 (\$79,975 if Married Filing Separately).

#### Exemption Amount Increased

The amount each taxpayer can deduct for each exemption increased to \$3,500.

#### Phaseout of Exemption Amount

Taxpayers with an adjusted gross income above a certain amount may lose part of the benefit of their exemptions. The amount at which the phaseout begins depends upon the filing status. For 2008, the phaseout begins at:

- \$119,975 - Married Filing Separately
- \$159,950 - Single
- \$199,950 - Head of Household, and
- \$239,950 - Married Filing Jointly or Qualifying Widow(er)

#### Standard Mileage Rate

- **Business-related mileage**

From January 1 through June 30, 2008, the standard mileage rate for the cost of operating a car, van, pickup, or panel truck for business use is 50.5 cents a mile.

From July 1 through the end of 2008, the standard mileage rate increased to 58.50 cents per mile.

- **Medical and move-related mileage**

From January 1 through June 30, 2008, the standard mileage rate for the cost of operating a vehicle for medical reasons or as part of a deductible move is 19 cents per mile. From July 1 through the end of 2008, the standard mileage rate for medical and move-related mileage increased to 27 cents per mile.

- **Charitable-related mileage**

For 2008, the standard mileage rate for the cost of operating your vehicle for charitable purposes remains at 14 cents per mile.

## **Earned Income Credit (EIC)**

- **Amount of credit increased**

For tax year 2008, the maximum credit is:

- \$4,824 for more than one qualifying child
- \$2,917 for one qualifying child
- \$438 for no qualifying children

- **Earned income amount increased**

To be eligible for a full or partial credit, the taxpayer must have earned income of at least \$1 and adjusted gross income less than:

- \$38,646 (\$41,646 if married filing jointly) and more than one qualifying child
- \$33,995 (\$36,995 if married filing jointly) and one qualifying child
- 12,880 (\$15,880 if married filing jointly) with no qualifying children

- **Investment income amount increased**

Taxpayers whose investment income is more than \$2,950 cannot claim EIC.

- **Advance payment of the credit**

Qualifying taxpayers can get advance payments of the credit up to \$1,750 from their employer with their pay.

- **Nontaxable combat pay election**

The election to include nontaxable combat pay in earned income for purposes of computing earned income credit was made permanent in taxable years after December 31, 2007.

## **Earned Income Amount for Additional Child Tax Credit**

For 2008, the minimum earned income used to figure the additional child tax credit increased to \$12,050.

## **Social Security and Medicare Taxes**

The maximum amount of wages subject to the social security tax for 2008 is \$102,000. There is no limit on the amount of wages subject to the Medicare tax.

## **Income Limits Increased for Student Loan Interest Deduction**

For 2008, the amount of the student loan interest deduction is phased out for taxpayers who are married and file jointly and whose modified adjusted gross income (MAGI) is between \$115,000 and \$145,000. If the MAGI is \$145,000 or more, no deduction is allowed. Married taxpayers who file separately do not qualify for the student loan interest deduction.



For Single, Head of Household, and Qualifying Widow(er) filing statuses, the student loan interest deduction is phased out for taxpayers whose MAGI is between \$55,000 and \$70,000. If the MAGI is \$70,000 or more, no deduction is allowed.

## Hope and Lifetime Learning Credits

- **Income limits for credit reduction increased**

For 2008, the amount of the Hope or Lifetime Learning Credit is phased out for taxpayers whose modified adjusted gross income (MAGI) is between \$48,000 and \$58,000 (\$96,000 and \$116,000 for a joint return). Taxpayers cannot claim an education credit if their MAGI is \$58,000 or more (\$116,000 or more for a joint return).

- **Hope Credit**

For 2008, the amount of the Hope credit (per eligible student) is the sum of the following:

1. 100% of the first \$1,200 of qualified educational expenses paid for the eligible student, and
2. 50% of the next \$1,200 of qualified education expenses paid for that student

The maximum amount of the Hope credit in 2008 is \$1800 per student.

## Deductible Long-Term Care Premium Limits Increased

For 2008, the maximum amount of qualified long-term care premiums includible as medical expenses has increased. Qualified long-term care premiums up to the amounts shown below can be includible as medical expenses on Schedule A (Form 1040).

- \$310 - Age 40 or under
- \$580 - Age 41 to 50
- \$1,150 - Age 51 to 60
- \$3,080 - Age 61 to 70
- \$3,850 - Age 71 and over



The limit on premiums is for each person.

## Income Limits Increased for Reduction of Education Savings Bond Interest Exclusion

For 2008, the amount of the interest exclusion is phased out for taxpayers – Married Filing Jointly or Qualifying Widow(er)s – whose modified adjusted gross income (MAGI) is between \$100,650 and \$130,650. If the MAGI is \$130,650 or more, no deduction is allowed.

For all other filing statuses, the interest exclusion is phased out for taxpayers whose MAGI is between \$67,100 and \$82,100. If the MAGI is \$82,100 or more, no deduction is allowed.

## Investment Income of Children Under a Certain Age

The rules regarding the age at which a child's investment income may be subject to tax at the parent's rate changed to include a child who is 18 or a student under age 24, whose earned income is not more than one-half of the child's support. The amount of taxable investment income these children can have without it being subject to tax at the parent's rate has been increased to \$1800 for 2008.

## **Maximum Tax Rate on Qualified Dividends and Net Capital Gain Reduced**

The 5% maximum tax rate on qualified dividends and net capital gains is reduced to 0%. The 15% maximum tax rate on qualified dividends and net capital gain has not changed.

## **Self-Employment Tax**

Self-employment tax consists of two parts, social security and Medicare. The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2008 is \$102,000. All net earnings of at least \$400 are subject to the Medicare part of the tax.

## **Traditional Individual Retirement Arrangement (IRA) Contribution and Deduction Limit**

The contribution limit to a traditional IRA in 2008, is the smaller of the following amounts:

- \$5,000 or
- The taxable compensation for the year.

For taxpayers that will be age 50 or older before 2009, the most that can be contributed to a traditional IRA in 2008 is the smaller of:

- \$6,000 or
- The taxable compensation for the year.

## **Modified Adjusted Gross Income (AGI) Limit for Traditional IRA Contributions Increased**

If a taxpayer is covered by a retirement plan at work, the deduction for contributions to a traditional IRA is reduced (phased out) if the modified AGI is:

- More than \$85,000 but less than \$105,000 for a married couple filing a joint return or a qualifying widow(er)
- More than \$53,000 but less than \$63,000 for a single individual or head of household
- Less than \$10,000 for a married individual filing a separate return

If only one spouse is covered by a retirement plan at work, and the taxpayers live together or file a joint return, the deduction is phased out if the modified AGI is more than \$159,000 but less than \$169,000. If the modified AGI is \$169,000 or more, no deduction for contributions to a traditional IRA is allowed.

## **Modified AGI Limit for Retirement Savings Contribution Credit Increased**

For 2008, taxpayers may be able to claim the retirement savings contribution credit if their modified AGI is not more than:

- \$53,000 for filing status Married Filing Jointly
- \$39,750 for filing status Head of Household
- \$26,500 for filing status Single, Married Filing Separately, or Qualifying Widow(er)

## Foreign Earned Income and Housing Exclusions

For 2008, the maximum foreign earned income exclusion increased to \$87,600. The base housing amount increased to \$38.30 per day or \$14,016 for an entire calendar year.

## Exclusion on Sale of Main Home by Surviving Spouse

For personal residence sales after 2007, a surviving spouse may exclude a gain of up to \$500,000 as long as the home was sold no later than two years after the spouse's death.

## Suspension of 5-year period during service with the Peace Corps

Peace Corps volunteers may elect to suspend the 5-year test period for ownership and use requirements applicable to the tax exclusion of gain from the sale of a personal residence while serving outside the United States.

## Additional Standard Deduction for Real Property Taxes

A deduction for property taxes of up to \$500 for single filers and \$1000 for joint filers is allowed for taxpayers who do not itemize.

## Refundable First-Time Home Buyer Tax Credit

First-time low and moderate income homebuyers may claim a refundable credit equal to 10% of the purchase price of the home, up to \$7,500 (\$3,750 for married individuals filing separately). Unlike other credits, this first-time homebuyer credit must be repaid over 15 years. It is essentially an interest-free loan for qualifying homeowners.

## Form 8888, Direct Deposit of Refund to More Than One Account

Information was added to Form 8888 General Instructions about direct deposits of refunds to TreasuryDirect online accounts.

## Expired Tax Benefits

The following tax benefits have expired and will not apply in 2008:

- Deduction for educator expenses in figuring AGI
- Tuition and fees deduction
- Deduction for state and local general sales taxes
- District of Columbia first-time homeowner credit (for homes purchased after 2007)
- Nonbusiness energy property credit
- Qualified charitable distributions from an IRA



At the time this publication went to print, Congress was considering legislation that would reinstate these benefits. To find out if this legislation was enacted, go to [www.irs.gov](http://www.irs.gov) for current information on tax changes.

[illegible]

### Welcome

Welcome to the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) Process Based Training Guide. We're glad you decided to take advantage of this challenging, yet rewarding experience as an important player in the tax administration process. The primary goal of the VITA/TCE program is to provide free tax return preparation for eligible taxpayers that is accurate and complete.

### Introduction

In order to be a successful tax preparer, you need to:

- Understand and have compassion for all types of people
- Know where and how to get the “right answer”
- Understand and apply tax law, and
- Prepare accurate returns

This course provides you with the guidelines and tools needed to prepare an accurate return for each taxpayer. Unlike most classes, there is no need to memorize a lot of information – everything about this course is open book.

This training material will introduce you to the major components of the VITA/TCE return preparation process and demonstrate how they contribute to your ultimate goal – preparing a complete and accurate return. The components of the process are:

- Screening and interviewing taxpayers using Form 13614-C, Intake/Interview & Quality Review Sheet or approved alternative form
- Understanding and applying tax law
- Using references, resources, and tools including TaxWise®, the IRS-provided return preparation software
- Conducting quality reviews



The process to complete an accurate return is the same whether you prepare tax returns using computer software or prepare the return on paper.

Your ability to prepare an accurate return will be measured in two ways:

1. The testing and certification process – used initially to gauge your understanding of the return preparation process
2. Quality review results of the returns you prepare – demonstrate your proficiency in all aspects of the process

If you gain an understanding of tax law and follow the VITA/TCE process, you should complete an accurate return each and every time.

This **course** is designed to guide you through the basics of tax law and tax return preparation using all the components of the process. You will learn how to use all your resources to find the answers to frequently asked questions and assist taxpayers in filing an accurate and complete return.

\*TaxWise® is a copyrighted software program owned by Universal Tax Systems, Inc.® (UTS).

## Objectives

After completing this course, you will be able to:

- Solicit appropriate information from the taxpayer to complete an accurate tax return
- Use your resources to determine if the taxpayer must/should file a return
- Accurately fill out Forms 1040EZ, 1040A, and 1040 with or without computer assistance
- Use your resources to accurately answer questions about filing a tax return
- Use your resources to accurately and appropriately select and fill out additional forms and schedules that should accompany each return
- Use your resources to find answers to any questions regarding filing a tax return
- Test and become certified to be a volunteer tax return preparer

In this **lesson** you will learn about:

1. The course of study as presented in this book and the associated workbook, test, and reference books
2. Important information about the VITA/TCE program and the role of the volunteers
3. The approved VITA/TCE process for preparing tax returns

At the end of this lesson you will be able to describe:

- The major features of the course materials
- The major components of the VITA/TCE process
- The rights and responsibilities of a volunteer
- The resources available to assist you

Your course instructor will provide the technical publications and forms required for this course.

## What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Approved Quality Review Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491
- ☐ Publication 4491-W
- ☐ Form 6744
- ☐ Form 13222
- ☐ Form 13615

### Optional:

- ☐ Publication 3
- ☐ Publication 596
- ☐ Publication 972
- ☐ Publication 4299
- ☐ Publication 4403
- ☐ Publication 4575
- ☐ Form 13645
- ☐ Internet Access (optional but highly recommended)



Prior to assisting taxpayers at the VITA/TCE Site, be sure to complete the "Are You Ready to Get Started?" assessment in the front of the Volunteer Resource Guide.



Seek feedback from your sponsor about the accuracy rate of the returns completed at your site.

## What is included in this guide?

This guide consists of this introduction and 35 lessons presented in basically the same order as the major sections of Form 1040 (for example, *Label*, *Filing Status*, *Exemptions*, *Income*, *Adjusted Gross Income*, *Taxes and Credits*, *Other Taxes*, *Payments*, and *Refund/Amount You Owe* sections). Each lesson typically incorporates the following components:

- The VITA/TCE program's integrated process for preparing accurate tax returns
- Instructions for completing a tax return using TaxWise software

- Concise explanations of basic tax law relevant to taxpayers with low to moderate incomes
- An ongoing scenario of a profiled taxpayer, Vanessa Franklin, to demonstrate the process of interviewing a typical taxpayer, using the research tools, and preparing an entire Form 1040. Appendix A contains the interview with Vanessa. Appendix B contains Vanessa's tax return documentation, completed tax return, and supporting forms and worksheets, as well as her intake/interview and quality review sheet. Appendix A and B are perforated and can be pulled out, if desired.
- Exercises providing you with the opportunity to check your understanding of the content
- A listing of forms and references you'll need for each lesson in the "What do I need?" section
- Tips, Cautions, and TaxWise Hints to help you remember key points in each lesson
- Draft forms – since these training books are printed before all tax forms for the next year have been finalized, some of the forms shown in the training materials have an imprinted "draft as of [date]" watermark. These forms may be found in this book, Publication 4491-W, Workbook Comprehensive Problems and Practice Exercise, and Form 6744, Volunteer Test/Retest. Final copies of the products can be found at [www.irs.gov](http://www.irs.gov) by the beginning of the tax year, and may have supplemental changes.



Before using any form imprinted with a "draft as of [date]" watermark, be sure to compare the final forms from [www.irs.gov](http://www.irs.gov) or a new Publication 17, an Instruction booklet (e.g. Form 1040 Instructions) or other publication. If there are differences, then make sure you understand the reasons for the changes between the final product and the form in the training materials before helping taxpayers with their returns.

There are five courses presented in this publication, each representing a level of certification. The first seven lessons apply to all levels of certification. Beginning in Lesson 8, the level of certification for the subject being covered will be indicated by the following icons:



**Basic** covers the completion of wage earner type returns.



**Intermediate** covers completion of returns for wage earners who receive pension income, and more complex Forms 1040. It requires completion of the Basic course.



**Advanced** covers the completion of the full scope of returns. It requires completion of the Basic and Intermediate courses.



**Military** covers the full scope of returns presented by members of the Armed Forces, Reserve, and National Guard. It requires completion of the Basic and Intermediate courses.



**International** covers the completion of returns for non-Military taxpayers living outside the United States who are assisted by volunteers working at U.S. Embassies and Consulates or other areas. It requires completion of the Basic and Intermediate courses.

Icons are displayed after the lesson title. If a section of a lesson is associated with only one certification level, the corresponding icon is displayed at the beginning of that section.

- If no icons are displayed in a section, all icons displayed after the lesson title apply

### **What is process based training?**

Process based training is a structured, fact-gathering process to help you prepare an accurate return. To complete the process, you will:

- Use the intake questions from Form 13614-C, Intake/Interview & Quality Review Sheet or approved alternative form to screen the taxpayer for eligibility, and prepare the return.
- Use reference materials, such as Publication 4012, Volunteer Resource Guide, Publication 17, Your Federal Income Tax for Individuals, and TaxWise help features as well as other resources available at your site, to prepare the return. These materials will provide you with standardized questions to ask during your interview with the taxpayer in order to help you prepare a 100% accurate tax return.
- Use an approved quality review sheet to check the quality of all completed returns. Adhering to a quality review process helps ensure high quality returns at all VITA/TCE program sites.

In most cases, when you have completed the return, it will be filed electronically. There should only be rare instances when the taxpayer may need to mail the tax return to the IRS.



IRS e-file is a quick and easy alternative to traditional paper returns. Most VITA/TCE volunteer sites are now set up for electronic filing using TaxWise software.

### **What will I learn from this guide?**

When you have completed this guide, you will be able to:

- Become a certified volunteer tax return preparer by taking the test(s) located in the Link and Learn Taxes e-learning course on [www.irs.gov](http://www.irs.gov) (or on paper if this option is not available to you)
- Conduct the initial interview and screen the taxpayer using an approved intake and interview sheet
- Determine whether the taxpayer is required to file a tax return
- Use reference and technical materials, such as the Volunteer Resource Guide and Publication 17, to ensure that you ask the correct questions during your dialog with the taxpayer, in order to prepare an accurate and quality tax return
- Correctly complete a 1040 series return, as well as accompanying tax forms, using TaxWise
- Use the quality review process to check the taxpayer's return
- Conclude the interview and assemble the return
- Prepare the return for electronic filing using TaxWise, a copyrighted software program owned by Universal Tax Systems and licensed by the IRS for use at VITA/TCE sites



Evaluations are an important part of our continuing efforts to improve the training offered to volunteers. We appreciate feedback as it is a vital contribution to the success of the program. A course evaluation form (Form 13222, Student Evaluation) is included in your kit.

## What other resources are available to help me learn?

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Publication 4491-W, a companion book to this course, provides many opportunities to practice tax return preparation using the information taught in this guide.

Directions at the end of many lessons identify specific problems in Publication 4491-W that will allow you to practice the lesson material. Although it might not be possible to work each exercise suggested with the knowledge you have at that point, at the end of the course, you will have the opportunity to complete all of the comprehensive problems and exercises in Publication 4491-W.

You may use the Practice Lab integrated with the online course, Link & Learn Taxes, to complete exercises, practice returns, and test scenarios using TaxWise.

## What are my responsibilities as a VITA/TCE program volunteer?

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As a VITA/TCE program volunteer, you have a responsibility to provide quality service and to uphold the ethical standards of the program. When you begin as a volunteer, you will be asked to sign Form 13615, Volunteer Agreement, Standards of Conduct, which states that you will adhere to these standards:

- Treat all taxpayers professionally, with courtesy and respect.
- Safeguard the confidentiality of taxpayer information.
- Apply the tax laws equitably and accurately to the best of your ability.
- Only prepare returns within the scope of your training and experience.
- Exercise reasonable care in the use and protection of equipment and supplies.
- Do not solicit business from taxpayers you assist or use knowledge you gained about them for any direct or indirect personal benefit for you or any other individual or organization.
- Do not accept payment for services provided. (Note: You may receive compensation from your site sponsor.)

Ensure the standards addressing return preparation are followed. These include becoming certified, using the intake and interview process, using reference materials, using the approved quality review process, completing the steps to electronically file tax returns, and adhering to the privacy and confidentiality guidelines.



Identity theft is a growing problem and you need to do all you can to prevent taxpayer information from ending up in the wrong hands.



Do not solicit or accept payment from taxpayers for services you provide.

## Am I legally liable for returns I prepare?

Because they accept payment for preparing a tax return, paid preparers are legally liable under federal law for the returns they prepare. VITA/TCE program volunteers are not considered paid preparers. This means you cannot accept payment of any kind from the taxpayer for preparing a federal tax return or for providing any other tax-related assistance. You are also protected by the federal Volunteer Protection Act of 1997, as long as you are acting within the scope of your volunteer responsibilities and the harm was not caused by willful or criminal misconduct.

### TIP

Access a copy of this Act on the Internet by typing "Volunteer Protection Act of 1997" into any search engine.

## How do I maintain the taxpayer's trust?

Taxpayers will trust that all information you receive from them is protected from disclosure. To maintain this trust:

- Do not disclose any personal tax information gained as a result of the service provided.
- Do not openly discuss taxpayers by name in the presence of other volunteers or taxpayers. You may discuss tax situations with other taxpayers and volunteers. For example, a volunteer may refer to a situation (not a taxpayer) and ask or give advice about the appropriate tax treatment for that specific situation.
- Do not retain taxpayers' documents for a follow-up visit. If you cannot fully complete the taxpayer's return at the time of service, return all documents to the taxpayer.
- Do not take taxpayers' information for preparation of the return outside the presence of the taxpayer, unless it is for a quality review. Be sure to explain to the taxpayer what you are doing with their information.
- Do not prepare a tax return when you suspect an individual is not providing truthful information.

### TIP

More information can be found in Publication 4299, Privacy and Confidentiality – A Public Trust.

Some individuals may attempt to defraud the government by filing false tax returns. If you have any question at all about the validity of information provided by a taxpayer, or are uncomfortable with a taxpayer situation, discuss your concern with your Site Coordinator or another individual in charge of the site.

There are many cases each year in which a couple files a joint return and then later, one or both individuals file a return as Head of Household, using the same dependent information. Since only one original return can be filed each year using any given social security number, this scenario can cause a delay in processing any or all of the returns associated with that social security number. Credits and/or deductions may be disallowed. If you are assisting a taxpayer whom you believe fits this scenario, consult with your Site Coordinator.

### TIP

You are the key to the integrity of the VITA/TCE program.

## What types of returns can I prepare?

It is important that you assist only with returns, supporting schedules and forms for which you have been trained and certified. The training resources and tools discussed in this guide only support the completion of a basic Form 1040 and associated tax

forms. A complete list of what is within the scope of the VITA/TCE program can be found in the Volunteer Resource Guide (Tab 14).

### How does the IRS identify volunteer-prepared returns?

Each paper or electronically filed return should be identified with the appropriate site identification number (SIDN) to ensure that all volunteer-prepared returns are readily identifiable by the Internal Revenue Service. Your SIDN is an 8-digit number preceded by the “letter S” which must be entered on all returns you prepare (Form 1040, Form 1040A, and Form 1040EZ) – both paper and electronic. Your Site Coordinator provides this number along with other necessary guidelines for completing the return.

The SIDN should appear in the “Paid Preparer’s Use Only” section of the return and will be discussed in detail in Lesson 19, Quality Review of Tax Return.



Remember to refer taxpayers with tax situations outside your scope of training, experience and certification to your Site Coordinator and/or a professional tax preparer.

### Will I receive certification as a trained volunteer?

To participate in the VITA/TCE program, you must pass at least the Basic certification test. After your Basic certification, you can test for Intermediate certification. Once you have achieved **both** of these certifications, you may test for any or all of the other certifications (Advanced, Military, and International). You may take online tests that are available in the IRS’ Link and Learn Taxes e-learning course on [www.irs.gov](http://www.irs.gov). Online testing is fast and efficient; you will know immediately if you have passed and can print out the certification for your Site Coordinator. Volunteers who do not pass the test the first time may review the course material and try again. A paper test (Form 6744) may also be available. Talk with your facilitator or Site Coordinator for more information on these options.

All volunteers must complete and pass the IRS test before training others in how to complete tax returns, preparing tax returns, transmitting tax returns, or conducting quality reviews on completed returns.

If a volunteer does not achieve the minimum required score on the Test or the Retest they are encouraged to participate in the program in another capacity such as greeter, publicity/communication, or resource acquisition, among others.

When you pass the test, your Site Coordinator or instructor may provide you with a VITA/TCE program Wallet Card, Form 13645.

The Wallet Card was created to acknowledge the accomplishment of certified volunteers, as well as to assist internal and external stakeholders in identifying certified volunteers. This credential provides an objective measure that you have mastered enough tax law to prepare returns. If provided, you should bring your Wallet Card to the tax preparation site for identification purposes.



You may take the test for this course online and receive immediate feedback. Your test is scored online. If you pass, you can print your Volunteer Agreement or course certificate from Link & Learn.

## Are there other materials available to assist me?

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When you arrive at the tax preparation site, your Site Coordinator will assist you with your resource needs. Your site may even have a technical research library from which you can access various forms, publications, and worksheets.

You should not use this training guide at your tax preparation site. It is designed for training purposes only. Take the Volunteer Resource Guide and Publication 17 with you for use at the site. Your Site Coordinator should be able to provide access to the following key resources as well:

- Instruction booklets, schedules, and worksheets for Forms 1040, 1040A, and 1040EZ
- Tax information publications that are frequently used at the sites (e.g., Publication 596, Earned Income Credit, Publication 972, Child Tax Credit, Publication 3, Armed Forces Tax Guide, etc.)
- Equipment and supplies along with security requirements and use restrictions
- Volunteer Quality Alerts



Recipients of government property and equipment must certify that the equipment will be used for volunteer tax return preparation purposes. Commercial and certain personal uses of the property may terminate the agreement. This applies to hardware and software, as well as supplies.

You may also reinforce your tax law training by viewing online training resources such as Link & Learn Taxes and Understanding Taxes – e-learning courses on [www.irs.gov](http://www.irs.gov).

There is also a toll-free tax information hotline available for volunteer use only. If you have a tax law question and cannot get the answer from your Site Coordinator or your reference material, you can call 1-800-829-8482 (1-800-TAX-VITA). If you call, be sure to identify yourself as a volunteer. **Do not give this phone number to taxpayers.** The volunteer hotline is generally available from February 1 until the filing deadline. This number can be found on the back cover of the Volunteer Resource Guide.



Handy contact information is listed near the back of the Volunteer Resource Guide.

## How do I get started using the tax software?

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If you are working at a site that uses tax preparation software, you will need to become familiar with the particular software package being used at your site. IRS contracts with a specific software company to provide software for use in the VITA/TCE program. The current provider is TaxWise from CCH/UTS.

Since the majority of sites use this package, IRS training materials are geared to the use of TaxWise (desktop version) and TaxWise Online (TWO) (internet based version).

Your instructor and/or Site Coordinator will provide you with the information and passwords required for logging into the program for training and/or tax preparation purposes. How to Use the Guide in the Volunteer Resource Guide will provide more information for making a comparison.

## Where do I find information about TaxWise and TaxWise Online?

The Volunteer Resource Guide provides general information and helpful hints for using TaxWise under the yellow tabs. Information specific to the TWO version is listed under the blue tabs. Information about completing the return is listed under the Finishing the Return tab.



Only use the Override Function in TaxWise with permission from your instructor or Site Coordinator.

## Summary

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Welcome to the VITA/TCE program. Remember:

- Make sure you have the resources and support you need to provide each taxpayer with high quality service and an accurate return
- A return is accurate when tax law is applied correctly and each taxpayer's supporting documentation (including an approved intake and interview sheet) supports the entries on the return
- Know your rights and responsibilities and uphold the integrity of the VITA/TCE program
- Prepare returns:
  - that are within the scope of the VITA/TCE program
  - for which you have been certified
- Use VITA/TCE equipment and supplies (including hardware and software) for their intended purposes
- Complete the "Are You Ready to Get Started?" assessment in the Volunteer Resource Guide prior to assisting taxpayers to determine if you have everything you need to provide top quality professional service

## This image shows a full page of blank, lined paper. It features approximately 20 evenly spaced horizontal grey lines across its entire width, providing a template for writing or drawing. The margins are consistent on all sides.

### Introduction

This lesson assists you in developing interview and screening skills that will assure taxpayers that you have their best interest at heart and provide you the information necessary to prepare a complete and accurate return. You will be introduced to the tools available to help you conduct a probing interview during the taxpayer's initial screening for program eligibility.

A probing interview to determine important facts about the taxpayer is required before and during the preparation of the tax return as well as during the quality review process. The verbal and written information gathered during the intake and interview process will be used to prepare the taxpayer's return and to conduct a quality review of the return after it is completed.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Describe the elements of the intake and interview process
- Locate the tools that will assist you in Publication 4012, Volunteer Resource Guide
- Use the various communications techniques necessary to successfully elicit the information needed to prepare a complete and accurate return such as:
  - Building rapport
  - Asking effective questions
  - Using active listening
  - Overcoming communication barriers

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Approved Quality Review Sheet
- ☐ **Optional:** Publication 4475

### What is included in the intake and interview process?

When taxpayers arrive at a site, they should each be given an approved intake and interview sheet. During the intake process, you or a certified screener will use the approved intake and interview sheet to screen taxpayers for program eligibility and validate the information they have provided. Throughout the screening process, listen for clues that will assist in completing the return – marital status, number of children, relatives living with them, childcare expenses, potential to qualify for credits, unreported income (e.g., cash transactions), etc.

The intake and interview process must include the following (at a minimum):

- An interview with the taxpayer that includes explaining the tax preparation process and encouraging them to ask questions throughout the interview process
- Use of an approved intake and interview sheet
- Confirmation of the accuracy of the taxpayer's responses provided on the front of the approved intake and interview sheet by a certified return preparer

- Use of probing questions to ensure complete information is gathered
- Review of all supporting documentation, Form(s) W-2, 1099, etc.
- Request for missing or incomplete documentation, if applicable

As you work with the taxpayer, apply these interview techniques:

- Building rapport
- Asking effective questions
- Using active listening skills
- Overcoming communication barriers

## Where do I find the tools to assist me with this process?

The tools to assist you during the screening and interview process are included in the introductory section of the Volunteer Resource Guide, which is part of your training kit.



Form 13614-C, Intake/Interview & Quality Review Sheet, in the Volunteer Resource Guide, is the IRS version of the form.

## How do I use the tools?

### How do I use the approved intake and interview sheet?

Every volunteer tax preparation site gathers taxpayer information using an approved intake and interview sheet. No matter which approved intake and interview sheet you use, it must ask for the basic intake information needed for a complete and accurate return.

You will ask the taxpayers to complete Parts I through IV of the approved intake and interview sheet before meeting with you. Review their responses with them to ensure accuracy. You may assist taxpayers with their entries on page 1. As you conduct your interview, you will complete Part V of the form together.

Using the interview skills explained in these lessons, you will review each item on the approved intake and interview sheet with the taxpayer before you complete the tax return.

Form <b>13614-C</b> (September 2008)	Department of the Treasury – Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB # 1545-1964
<b>You (and Spouse) will need:</b> <ul style="list-style-type: none"> <li>• <i>Proof of Identity</i></li> <li>• <i>Social Security Card or Individual Tax Identification Number (ITIN) letter for all individuals to be listed on the return</i></li> <li>• <i>Copies of ALL W-2, 1098, 1099 forms</i></li> <li>• <i>Amounts of any other income</i></li> <li>• <i>Child care provider's identification number</i></li> <li>• <i>Amounts/dates of estimated or other tax payments made, etc.</i></li> <li>• <i>Bank documents showing routing and account numbers if requesting direct deposit/debit</i></li> </ul>		

If a correction to the taxpayer's information is required during the intake and screening process, it should be annotated on the approved intake and interview sheet prior to completing the return. These notes expedite the tax return preparation and the quality review process.



## How do I use the Volunteer Resource Guide?

The Volunteer Resource Guide will help you as you interview the taxpayer. It includes decision trees, interview tips, and other information to gather, clarify, and verify the taxpayer's information on the approved intake and interview sheet.

The Volunteer Resource Guide is divided into four major sections – General Information, Tax Law, TaxWise and TaxWise Online:

- General information located in the front section and the covers of the book offers guidance and a copy of Form 13614-C, Intake/Interview & Quality Review Sheet
- White tabs contain tax law in the form of decision trees, charts and interview tips
- Yellow tabs contain step-by-step procedures for electronic return preparation using TaxWise software
- Blue tabs contain information specific to users of the web-based option for TaxWise

TaxWise Online users should take advantage of both the yellow and blue tabs as material which is universal for both applications will be contained in the yellow tab section.

### TIP

Information from the Volunteer Resource Guide is referred to throughout this training. You must use it at your VITA/TCE site, so refer to it often during class to prepare for your taxpayer interviews.

## How do I conduct a quality review?

An approved quality review sheet will assist you in identifying where errors commonly occur on the tax return. Use it to check the completed return before the taxpayer signs the return and leaves the site.

The use of an approved quality review sheet is discussed in detail in Lesson 32, Quality Review of Tax Return. It can be referenced during the intake process to alert you to areas of emphasis that will be important during the quality review.

This year, the IRS Intake and Interview Sheet and the Quality Review Sheet have been combined into Form 13614-C, Intake/Interview & Quality Review Sheet. The intake and interview sheet now comes only in this format. Form 8158, Quality Review Sheet, can still be ordered as a separate form and, except for the heading, is identical to the quality review sheet in Form 13614-C.

## Quality Review



This form is used to Quality Review the completed tax return based on the Intake/Interview Sheet, the documents provided for the return preparation, and a conversation with the taxpayer.

- Involve the taxpayer in the Quality Review process.
- Complete this form prior to obtaining the taxpayer's signature on required tax forms.
- Compare the completed return with the Intake/Interview Sheet and all supporting documents.

**Quality Reviews complete the Quality Process and help ensure an accurate return.**

### Verifying the Return

*Check each item only when you verify that the review step is complete.*

1. ☐ Yes ☐ No A completed **Intake/Interview Sheet** was used to prepare this tax return.



**TaxWise Hints:** Partners may use forms provided in the TaxWise software in lieu of an approved intake and interview sheet. When choosing this option, the volunteer preparer must ensure that all required questions are asked by using the following TaxWise worksheets:

1. Main Information Sheet (mandatory)
2. Interview Sheet (Interview Questions) (mandatory)
3. Dependent Worksheet (Dependent Exemption Eligibility Due Diligence Worksheet) (if required)
4. Head of Household Worksheet (if required) and
5. Earned Income Credit Worksheet (if required)

Partners choosing this method must provide paper copies of the TaxWise forms, or access to the forms online, to the reviewer conducting a quality return review.

## How do I welcome and screen the taxpayer?

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### How should I welcome the taxpayer?

Here are suggestions for welcoming the taxpayer:

- Greet the taxpayer and introduce yourself
- Take a few moments for small talk (weather, traffic, etc.)
- Explain the screening, tax preparation and quality review processes
- Explain that you will complete Part V of the approved intake and interview sheet together, after they complete Parts I through IV
- Ask if the taxpayer has any questions



If not shown in class, ask your instructor about Publication 4475, Interview Techniques, which is available in DVD or VHS. It is an excellent demonstration of the entire intake and interview process.

Here is an example of how Jorge, a volunteer welcomed Bill, a taxpayer:

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

BILL RESPONDS...

*Hello, I'm Jorge. How are you today?*

Hi, I'm Bill. I'm fine. How about you?

*I'm fine, thanks. Did you have any trouble finding the place?*

It wasn't too bad. The traffic was terrible though!

*Yes, especially this time of day. Did the receptionist ask you to complete an intake sheet like this one?*

Yes, I have it here.

*Thank you. I'll have to see your photo ID and social security card and then I'll check your income to make sure you qualify for volunteer assistance. Next, we'll go over your information together and make sure it's complete. Then I'll input the information into the computer to create your tax return. Finally, I'll go over the return with you, and have it reviewed for accuracy. You will then be able to sign and date it. Do you have any questions?*

If I sign and date it, do I have to mail it right away?

*I'm glad you asked that. We normally file your return electronically, so you won't have to mail your return at all. Do you have any other questions before we look at your intake sheet?*

I don't think so.

*Okay, but please feel free to ask questions as we go along. The tax process isn't always clear to people, so it's always good to ask, okay?*

Sure, I appreciate that, thanks.

### How can I screen the taxpayer for eligibility?

When the taxpayer indicates that their portion of the approved intake and interview sheet is complete, begin the interview to complete the form and then screen the taxpayer for eligibility for the volunteer program. Screening methods differ between volunteer sites, but here are suggestions for this step:

- Ask the taxpayer for their approved intake and interview sheet.
- Verify the taxpayer's identity with a picture ID or other acceptable method.
- Compare social security numbers (SSNs) or Individual Tax Identifying Numbers (ITINs) with social security cards or other acceptable documentation taxpayer has brought.
- Review the taxpayer's income information, such as Form(s) W-2, and Form(s) 1099, to determine if they fall within the scope of the volunteer program. Your Site Coordinator and/or instructor will let you know the tax return criteria for your program. If they do not fall within the scope of the program:
  - Courteously explain that volunteer services are limited to those who fall within the scope of the program and why they do not qualify.
  - Encourage the taxpayer to use the information they recorded on the intake and interview sheet in working with another tax preparation service.
  - Thank the taxpayer for coming and express regret that you cannot assist them.
- If the taxpayer qualifies for volunteer assistance, begin the interview and complete the approved intake and interview sheet. If taxpayers qualify but do not have all the necessary documentation, provide guidance necessary for them to acquire the documentation.

Here is an example of how a volunteer screened taxpayer Robert Cornell for assistance:

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Mr. Cornell, you might be aware that the volunteer program is limited. We are volunteers and can only do tax returns within the scope of our training. Did anyone let you know that?*

*Well, we'll certainly do whatever we can. First, let's look at your Form W-2, interest statements, and anything else that reports your income. May I look at those?*

*I'm sorry to tell you, but rental income is outside the scope of volunteer training. I'm afraid we won't be able to help you.*

*I'm afraid so. However, you are welcome to take the intake sheet with you – it may be helpful as you work with another preparer to complete your return. I'm sorry we weren't able to work together.*

*Yes, but thank you so much for coming in.*

#### ROBERT RESPONDS...

No, not really. I hope you can help me.

Sure, here they are. I also own a duplex and collect some rent from it.

Oh, I'm disappointed. Are you sure?

Well, me too, but rules are rules, I guess.

Okay, thanks anyway.

### How do I conduct a probing interview?

As you become experienced with interviewing taxpayers, you will develop your own approach. Use the techniques you will learn in the next section, such as building rapport, asking effective questions, and active listening. As you use these techniques in an interview, be sure to cover these points:

- Review the taxpayer's portion of the approved intake and interview sheet.
- Ask if they were uncertain about any responses. Reassure them that you will help them complete the form accurately.
- Explain the tax preparation process and encourage them to ask questions throughout the interview.
- For each part of the approved intake and interview sheet, use the Interview Tips or a Decision Tree in the Volunteer Resource Guide to probe for accurate and complete information.

Open the Volunteer Resource Guide to the Decision Tree and Interview Tips located behind Tab B. The sample interview below demonstrates how a volunteer uses these tools to conduct a small part of a probing interview with Regina Reinhardt about which filing status is appropriate:

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

REGINA RESPONDS...

*Ms. Reinhardt, were you uncertain how to answer any of the questions on the intake sheet?*

Yes, actually I had trouble with the dependents section.

*Okay, as we go over that part. I'll explain a little more about what they are looking for. You should feel free to ask questions. Fair enough?*

Yes, thanks.

*I'm going to ask you a few questions that will help us determine the best filing status for you and then we will go over your dependent information. First, I see from your intake sheet that you were married as of the last day of the tax year. Is that right? (Step 1)*

Yes, I was, but my husband and I were living apart.

*So, he was not living with you?*

That's right. But we were still legally married.

*Okay, do you plan on filing a joint return with your spouse? (Step 2)*

Well, I'm not sure... I don't really like the idea of it. I was thinking of filing separately. Can I do that?

*Yes, of course. Let's assume for now that you will file separately, and I'll ask you a few more questions. I see that you have two children. Did they live in your home during the tax year? (Step 3)*

Yes, they lived with me.

As you can see, the volunteer used the tips in a natural and personal way. You will learn more about this approach in this lesson's section on interview techniques.



## EXERCISES

Read the interviews and then answer the questions that follow. Answers are located after the lesson summary.

**Question 1:** From the list below, mark all the things the volunteer did.

- Greeted taxpayer
- Introduced himself or herself
- Made small talk
- Explained screening and tax preparation processes
- Asked taxpayer to complete the approved intake sheet to the best of their ability
- Asked the taxpayer if they had any questions

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

ROBERT RESPONDS...

*Yes?*

I'm here to do my taxes.

*Here, fill out this intake form. You may sit over there.*

What do I do when I'm finished?

*Come back to me. Do you have any other questions?*

No, thanks... I guess!



## EXERCISES (continued)

**Question 2:** From the list below, select all the things the volunteer did.

- Reviewed the approved intake and interview sheet
- Asked if taxpayer was uncertain about any responses
- Reassured taxpayer that they would help them complete the form
- Encouraged questions

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

*Okay, let's take a look at your intake sheet. Did you have any questions about filling it out?*

*Okay, don't worry. Let's start at the beginning and go step by step. When we get to those questions, I'll explain what they mean, and we'll try to answer them together. How does that sound?*

*Please feel free to ask questions as we go over the intake sheet. Shall we begin?*

ROBERT RESPONDS...

Yes, I wasn't sure what this question meant, and this one here.

That will help!

Yes, let's get started.

## How do I use the interview techniques?

### What are the techniques?

As you use the intake and interview tools, you will need to put the taxpayer at ease and keep communication open. Applying these techniques can help you do that:

- Building rapport
- Asking effective questions
- Using active listening skills
- Overcoming communication barriers

### How do I build rapport?

You want the taxpayer to feel comfortable with you. Try to establish the taxpayer's trust and confidence from the beginning. As you welcome the taxpayer:

- Be friendly and respectful
- Have materials organized
- Speak clearly and simply

Explain the process and make sure the taxpayer understands what will happen next. Encourage the taxpayer to ask questions. The sample interview presented earlier in this lesson is a good example of how a volunteer built rapport with a taxpayer.



## How can I ask effective questions?

Working with a taxpayer requires you to ask many questions. You may feel that you are prying. You are not. You're eliciting the information needed to file an accurate return that allows taxpayers to enjoy all the benefits or credits they are due. When you start an interview, use one or two *open-ended* questions. These kinds of questions require more than a simple Yes/No answer.

Even questions on the approved intake and interview sheet that simply ask for a Yes/No response may confuse a taxpayer. A good approach is to ask the first key tax question and then explain why the information is necessary. This helps the taxpayer give a more accurate and focused answer.

Avoid asking *leading* questions because they make the taxpayer feel you have a specific answer in mind. Do not make assumptions about taxpayers – let them speak for themselves.

Here is how a volunteer used effective questioning with Dorothy Stone:

### TIP

Asking open-ended questions lets the taxpayer decide what is important, and that can help you discover special situations. For example, "*What changes have you had this year that might make your tax situation different from last year?*" and "*What more can you tell me about that?*"

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Okay, Ms. Stone, I need to get some basic information today so we can complete your return. Before we do that, what tax documents did you bring with you today?* [open-ended question]

*When we sat down, you mentioned that you and your husband separated or divorced last year. Did you bring any paperwork related to that?*

*Okay, that's good. Let's go over your intake sheet. Were you still married on December 31st of last year? What I mean to ask is, "did you receive a final decree of divorce by December 31st?" I need to ask so I can figure out how you should file.*  
[question with explanation of why it is needed]

*I see, thank you. Now that we have clarified your marital situation, we can determine which exemptions you can claim.*

#### DOROTHY RESPONDS...

My W-2s and interest statements.

Oh, yes, sorry. Here it is.

Well, we went to court and filed for the divorce on September 1st, but we won't have a final decree until the end of February, or beginning of March of this year.

Okay.

## How do I use active listening skills?

Active listening shows that you are paying close attention. It reassures the other person that you care about what they have to say and that they can trust you. We all use active listening when we are truly interested in what someone is saying. Here are ways we show that we are actively listening:

- Using nonverbal cues such as nodding, smiling appropriately, and making eye contact
- Letting the other person take the time they need to express themselves
- Responding by restating what the other person has said to ensure that you understand
- Expressing sympathy or other appropriate emotions

Here is how a volunteer demonstrated active listening in an interview with Marsha:

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*I see that you left blank the question about whether you were living with your spouse on December 31st.*

*I see. [nodding] Can you tell me a little more?*

*I see. Thank you for the information. I know how difficult a situation like that can be. [expressing sympathy]*

#### MARSHA RESPONDS...

Yeah, I wasn't sure what to put there. My situation was kind of complicated at the end of last year.

I guess so. My husband moved out in October, but he comes back sometimes to visit the kids.

### How can I overcome communication barriers?

Communication can hit a barrier if the taxpayer becomes upset or defensive. When this happens, you can often overcome barriers by showing that you understand the taxpayer and care about their concerns, feelings, and needs. Here are a few ways to do that:

- Do not become upset
- Reassure the taxpayer (Example: "I hear you" or "I understand")
- Keep on track by asking the tax question
- Provide a motivator (Example: "This is difficult, but I need this information so I can make sure you are allowed all the benefits available to you.")
- Use your active listening skills
- Allow the taxpayer enough time to respond
  - If the taxpayer is silent, encourage them by saying, "Tell me more about that..."
  - If the taxpayer is upset, show that you understand by paraphrasing what they have told you

Here is an example of how a volunteer overcame barriers to communicating in an interview with Jack Butler:



The introductory information in the Volunteer Resource Guide contains interview steps and suggested actions.



## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*I'm sorry, according to this information, you don't qualify for the deduction.*

[not upset, sympathetic] *I understand, Mr. Butler, nobody wants to pay more taxes.* [paraphrasing, understanding] *Keep in mind that we're still trying to identify the deductions you **can** take, so your taxes will be as low as possible. Let's look at the next set of deductions, okay?* [did not become upset, kept on track by asking the tax question]

*Take your time, Mr. Butler. Tell me more when you are ready.* [gave taxpayer time to respond, asked him to "tell me more"]

*Well, it makes sense that you would be concerned about being able to pay your tax bill on time.* [paraphrasing] *Now, if you end up owing more in taxes, we can discuss some possible options for payment. Shall we keep looking for deductions?*

### MR. BUTLER RESPONDS...

What? Are you saying that I can't take that deduction? That means I am going to owe taxes! I thought I was going to get a refund! I can't afford to pay more taxes!

Okay, I know, you're trying to help. I'm just afraid that...[*silent*]

I'm just afraid I won't be able to pay the bill on time.

Yes, thank you. Let's go on.

## What happens next?

Based on what you learn from the taxpayer's approved intake and interview sheet and from the interview, you have three options:

- Advise the taxpayer that their return is outside the scope of your training and seek assistance from your Site Coordinator. If there is another volunteer available who has the appropriate training, they can take over the interview.
- Advise the taxpayer that their tax situation is outside the scope of the program, or
- Assist the taxpayer with their return, request assistance from your Site Coordinator as needed. If the taxpayer qualifies but does not have all the necessary documentation, provide guidance necessary for them to acquire the documentation.

If the taxpayer's return is within the scope of the program and their tax situation is covered in your certification, you may complete their return. Refer taxpayers whose tax situations are outside your scope of training, experience and certification to your Site Coordinator and/or to a professional tax preparer.

If tax preparation assistance is not provided, return the approved intake and interview sheet to the taxpayer.

After the return is completed and the quality review is finished, the approved intake and interview sheet can be returned to the taxpayer along with a copy of their return(s) or



Successful volunteers express empathy, understanding and compassion for all types of people. Overcome barriers by letting taxpayers know you understand and care about them.

it can be retained until the return has been accepted. For guidance on proper procedures, consult the Site Coordinator at the site where you are volunteering.

## Summary

Knowledge of tax law and interview skills are required to identify taxpayers who qualify for volunteer return preparation assistance and to conduct effective probing interviews. Good interview techniques, combined with IRS or partner-developed tools, make the interview more effective and comfortable for you and the taxpayer. Remember, establishing rapport and educating taxpayers produces accurate returns.

Having the ability to communicate with all types of people, knowing where and how to get “the right answer,” understanding and applying tax law, and preparing accurate returns are the skills you will need to be a successful volunteer.

Necessary tools are:

- Approved intake and interview sheet
- Volunteer Resource Guide
- Approved Quality Review Sheet

Helpful interview techniques are:

- Building rapport
- Asking effective questions
- Using active listening skills
- Overcoming communication barriers

When assisting taxpayers, safeguard the confidential information they share with you.

### TIP

During the screening and interviewing process, strive to acquire the information needed to prepare 100% accurate returns, and make notes on the approved intake and interview sheet. Remember, a return is accurate when tax law is applied correctly and the return is based on information acquired during this process.



## EXERCISE ANSWERS

**Answer 1:** *The volunteer did a very poor job on almost all counts. The only thing he did right was ask if the taxpayer had any questions, but he did that rudely.*

**Answer 2:** *The volunteer did all of the recommended things and did them courteously!*

### Introduction

This lesson will help you determine which taxpayers must or should file a tax return. You will also find information on how to verify a taxpayer's identity, which form to use, and how long to keep taxpayer records.

### Objectives

At the end of this lesson, using your reference materials, you will be able to:

- Determine who must file a tax return
- Determine who *should* file a tax return
- Verify the taxpayer's identity
- Select the correct form to use
- File the return
- Tell taxpayers how long they should keep certain records and documents

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ **Optional:** Publication 552

### Who must file?

U.S. citizens or resident of the United States must file a return based on three factors – age, gross income, filing status. There are special rules for dependents, surviving spouses, U.S. Citizens and residents living outside the U.S., residents of Puerto Rico, and individuals with income from U.S. possessions.

Remember to use the interview techniques and tools discussed in the Screening and Interview lesson when determining who must file.

### What do I need to know?

To decide whether someone must file a tax return, you need to know the individual's:

- Age
- Gross income
- Filing status

Publications 17, Chapter 1 – Filing Information contains additional information for other individuals that must/should file a return – dependents, children under age 18, self-employed, aliens.

### ***Where do I get information on the taxpayer's age?***

Look at the approved intake and interview sheet for the taxpayer's date of birth. Confirm this date during the interview. Refer to the sample approved intake and interview sheet at the beginning of the Volunteer Resource Guide.

### Where do I get information on the taxpayer's gross income?

An approximation of gross income is enough to see if a taxpayer must file a return. Gross income is all the income the taxpayer received during the tax year in the form of money, goods, property, and services that are not exempt from tax. It includes both earned and unearned income.

The Income section of the Volunteer Resource Guide (Tab D) lists the sources of income that should be included and excluded in determining a person's gross income. You can also refer to the Income lesson.

To approximate gross income:

- Obtain the total of wages, tips, and other employment compensation reported in box 1 of the taxpayer's Form(s) W-2
- On page 2 of the approved intake and interview sheet, review the income questions with the taxpayer to see if there was any additional income (from investments, retirement plans, social security, unemployment, or other income not reported on Form W-2 or Form 1099) and determine each amount. Take a look at Parts III and IV on Page 2 of the sample approved intake and interview sheet at the beginning of the Volunteer Resource Guide.



Do not include social security benefits when determining filing requirement unless the taxpayer is married, filing a separate return, and lived with their spouse at any time during the tax year.

Total the above amounts of income to determine the taxpayer's approximate gross income.

### Where do I get information on the taxpayer's filing status?

Taxpayers may or may not know which filing status to use. For the purposes of determining whether a person must file a return, narrowing the choices down to the *most likely* filing status(es) is adequate in most cases.

#### example

Based on the approved intake and interview sheet shown below, this taxpayer will most likely use the Married Filing Jointly filing status.

14. Phone Number and e-mail address Phone: (000 ) 000-0000 e-mail:	15. Could you or your spouse be claimed as a dependent on the income tax return of any other person? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
16. On December 31 <sup>st</sup> a. Were you: <input type="checkbox"/> Single <input checked="" type="checkbox"/> Legally Married <input type="checkbox"/> Separated <input type="checkbox"/> Divorced <input type="checkbox"/> Widowed b. If married, did you live with your spouse during any part of the last six months of the year? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No c. Is your spouse deceased? If yes, provide the date of death. (mm/dd/yyyy)	

#### Part II. Family and Dependent Information – Do not include you or your spouse.

Print the name of everyone who lived in your home and outside your home that you supported during the year.

Name (first, last)	Date of Birth mm/dd/yyyy	Relationship to you (son, daughter, etc.)	Number of months person lived with you last year	US Citizen, Resident of US, Canada or Mexico (yes or no)	Is the dependent a full time student? (yes or no)
(a)	(b)	(c)	(d)	(e)	(f)
Joe Smith	01/01/2003	Son	12	Yes	No

Check the Taxpayer Information section of the approved intake and interview sheet for:

- The taxpayer's marital status
- Whether the taxpayer can be claimed as a dependent on someone else's tax return
- The taxpayer's potential dependents

Use the Volunteer Resource Guide's Determination of Filing Status decision tree and the Interview Tips, (Tab B) for helpful probing questions.

### Who is legally required to file a federal tax return?

To determine whether a taxpayer is legally required to file a return, start with the Volunteer Resource Guide (Tab A), Who Must File – Chart A-For Most People and Chart B-For Children and Other Dependents table. Turn to that table now and review the dollar amounts in both Charts A and B.

#### example

Lucy, is 36 years old, single, and her gross income is \$20,000. She must file a tax return and will use the Single filing status.

#### example

Henrietta and Javier are married and plan to file a joint return. Henrietta is 67 and had a gross income of \$11,000 for the tax year. Javier is 66. His gross income was \$5,000 for the year. Since their combined gross income is \$16,000, they do not have to file a return.

### For Special Situations

If the Who Must File charts show that an individual is not required to file a return, then continue to the Who Must File—Other Situations When You Must File in the Volunteer Resource Guide (Tab A) to see if any of the following special conditions require the person to file.

Some of the most common situations you may see when individuals are legally required to file a return are:

- **Self-employed** with net earnings of \$400 or more
- **Advanced Earned Income Tax Credit payment recipients** who have an amount in Box 9 of their Forms W-2
- **Taxpayers who owe Special Taxes**



#### EXERCISES

Refer to the Who Must File section of the Volunteer Resource Guide to answer these questions. Answers are at the end of the lesson summary.

**Question 1:** Bob is 27 years old. His gross income was \$9,050 during the tax year. Based only on this information, is he required to file a tax return?

☐ Yes ☐ No



## EXERCISES (continued)

**Question 2:** Janet and Harry are married and usually file jointly. During the tax year, she turned 66 and he turned 64. Their gross income was \$16,200. Based only on this information, are they required to file a tax return? ☐ Yes ☐ No

**Question 3:** Juanita can file as a Qualifying Widow with Dependent Children. She is 47 years old. Her gross income was \$15,400. Based only on this information, is she required to file a tax return? ☐ Yes ☐ No

## Who should file?

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Even if an individual is not required to file a tax return, they should file a return to get money back if they qualify in certain situations. Remember to use the interview techniques and tools discussed in the Screening and Interviewing lesson.

### Who should file a federal tax return?

Although some individuals may not be *required* to file, they *should* file a return if they are eligible to claim:

- A refund of withheld taxes
- The Earned Income Credit (EIC)
- The Additional Child Tax Credit
- The Health Coverage Tax Credit
- The Recovery Rebate Credit

Taxpayers who should file may be entitled to a tax credit and filing a return is the only way to get it.

These items are listed in the Volunteer Resource Guide (Tab A) Who Must File section, Chart D – Other Situations.

Individuals who are not required to file a return and who would not benefit from filing a return can reduce the cost, time, and effort of unnecessary processing by not filing a return.

### ***How do I find out if a taxpayer is eligible to claim a refund?***

To determine whether a person should file a return in order to claim a tax refund or refundable tax credit, check the taxpayer's:

- Form(s) W-2 (boxes 2 and 17) and Form(s) 1099
- The Family and Dependent Information section of the approved intake and interview sheet

The taxpayer may qualify for a tax refund, Earned Income Tax Credit, and/or Additional Child Tax Credit if:

- Federal or state income tax was withheld on any income form, and/or
- The taxpayer had earned income, and/or
- The taxpayer has a qualifying child

When in doubt, it may be worthwhile to begin a tax return for the taxpayer and then file the return only if the taxpayer is eligible for a refund.

Refer taxpayers who may qualify for the Health Coverage Tax Credit to a professional tax preparer.

**TIP**

The Earned Income Tax Credit may apply with or without a child. See the Earned Income Credit and Child Tax Credit lessons for details on determining eligibility for these tax credits.

## How do I verify taxpayer identity?

To verify a taxpayer's identity, use the interview techniques and tools discussed in the Screening and Interviewing lesson.

### What documents do I use to verify identity?

Before you enter the taxpayer identification information on the tax return, you should first verify the identity of the taxpayer(s), the accuracy of each SSN (or ITIN), and the spelling of names entered on the taxpayer's approved intake and interview sheet.

**TIP**

Identity documents consist of a driver's license (U.S.), employer ID, school ID, birth certificate, state identification card (U.S.), Military ID, national identity card, visa, or passport. However, any other valid form of identification that would normally be used to prove identity is acceptable.

- Ask to see a social security card, an ITIN letter, or other legal document for each individual who will be listed on the return
- Ask to see proof of identity for the taxpayer (and the spouse if filing a joint return)
- Verify the SSN (or ITIN) and proof of identity are for the same person
- Verify the SSN (or ITIN) and the spelling of each individual's name on the social security card or other acceptable documents match the information you enter on the tax return
- Verify the address and birth date on the approved intake and interview sheet matches the information on the identification and discuss any discrepancies with the taxpayers
- Make sure the taxpayer understands how critical it is to have the correct information in order to receive any age-related tax benefits

Taxpayers who cannot substantiate their identity should seek professional tax assistance.

### What are Taxpayer Identification Numbers?

IRS regulations require that each person listed on a U.S. federal income tax return have a valid Taxpayer Identification Number (TIN). The types of TINs are:

- Social security number (SSN)
- Individual Taxpayer Identification Number (ITIN)
- Adoption Taxpayer Identification Number (ATIN)

**TIP**

Some Canadians have both U.S. and Canadian social security numbers. Never use the Canadian number on a U.S. tax return.



## Who has a social security number?

Any individual who is legally eligible for employment in the United States must have a social security number (SSN).

## Who has an Individual Taxpayer Identification Number?

Some individuals who need to file tax returns do not have social security numbers. The IRS issues an ITIN to nonresidents and others living in the U.S. who are required to have a U.S. TIN but who are not eligible to obtain SSNs.

The ITIN contains nine digits and is formatted like an SSN (XXX-XX-XXXX), but begins with the number 9. You should enter the ITIN on the return wherever the social security number is requested.

## Who has an Adoption Taxpayer Identification Number?

Taxpayers who are in the process of adopting a child and who are able to claim the child as their dependent or are able to claim a childcare credit need an ATIN for their adoptive child.



Taxpayer, spouse, and dependent name and social security number mismatch is rated as one of the top 5 errors in processing a tax return.



Taxpayers who cannot obtain an SSN must apply for an ITIN if they file a U.S. tax return or are listed on a tax return as a spouse or dependent. These taxpayers must file Form W-7, Application for Individual Taxpayer Identification Number and supply documentation that will establish foreign status and true identity. A federal tax return must be associated with all Form W-7 applications with exceptions as noted in the instructions for Form W-7.



The IRS issues an ATIN for the child while final domestic adoption is pending, and the adopting taxpayers do not have the child's SSN.

Like an ITIN, the nine-digit ATIN begins with the number 9. You should enter the ATIN on the return wherever the child's social security number is requested.

## What are acceptable documents if the taxpayer doesn't have a social security card?

For individuals who do not bring their social security card, you may accept either of the following:

- An SSA letter
- An ITIN card or letter



Driver's licenses and passports are *not* acceptable substitutes for social security or TIN cards.



### ***What if the taxpayer doesn't have an SSN or ITIN?***

For individuals without a valid SSN, explain that they must have a taxpayer identification number before you can assist them. Direct them to the Social Security Administration and advise them to complete Form SS-5, Social Security Number Application. If the individual is not eligible for an SSN, refer them to the IRS for Form W-7, Application for Individual Taxpayer Identification Number.

For a taxpayer who cannot obtain an SSN and has not yet applied for an ITIN, you can use a temporary identification number to prepare the return in TaxWise. Turn to Apply for an ITIN, (Tab 1) in the Volunteer Resource Guide.

When preparing a tax return for an ITIN application, include all Forms W-2, even if the TIN on the W-2 does not belong to the taxpayer. Do *not* change any information on the W-2. Send it in with the return as is. Since it is not going to be transmitted electronically, it does not matter if the TIN does not match in TaxWise.

Attach the tax return behind Form W-7, Application for Individual Taxpayer Identification Number along with documentation that will establish foreign status and true identity and have the taxpayer submit according to Form W-7 instructions.

- If it is not available at the volunteer site, the taxpayer can obtain Form W-7 by calling the IRS at 1-800-829-3676 (1-800-TAX FORM) or at [www.irs.gov](http://www.irs.gov)
- If taxpayers need assistance in completing Form W-7, refer them to an IRS walk-in office or for professional assistance unless a volunteer at that site has been trained in completion of Form W-7 or an authorized acceptance agent is available

#### **TIP**

If preparing the return on paper, leave the TIN spaces on the return blank and follow the W-7 procedures.

### ***What if the TIN on the Form W-2 doesn't match the TIN on the tax return?***

SSN (or ITIN) on the taxpayer's Form W-2 is expected to match the one you entered on the tax return. A mismatch will delay return processing and can create serious errors.

#### ***Taxpayers with a valid SSN***

If the taxpayer's Form W-2 does not have the correct SSN, you can prepare the tax return with the materials provided. However, the taxpayer needs to request a corrected Form W-2 from the employer before submitting the tax return.

#### ***Taxpayers with a valid ITIN***

Taxpayers who file tax returns under their ITINs (and other taxpayers without valid SSNs), often attach Forms W-2 showing erroneous SSNs. If such an ITIN/SSN mismatch occurs:

- Do *not* change any information on the Form W-2
- Effective in 2006, it is acceptable to e-file a return with an ITIN/SSN mismatch
- The return should reflect the ITIN for the taxpayer, *not* the SSN on Form W-2
- When inputting the Form W-2(s), the mismatched SSN should be entered exactly as shown on the Form W-2 issued by the employer
- The taxpayer is not eligible for the Earned Income Credit (EIC)



## EXERCISES (continued)

**Question 4:** It is your responsibility as a volunteer tax preparer to check the accuracy of every social security number provided to you by taxpayers.

☐ True ☐ False

### How do I enter the identification data?

Turn to the Main Information Screen section in the Volunteer Resource Guide (Tab 1). Be sure to read all the details and helpful hints for entering the taxpayer's identification information.



**TaxWise Hint:** Input this section of the return on the TaxWise Main Information Sheet. TaxWise transfers the information to the appropriate tax form. You have the option of either filling in the forms or using the interview-based data entry to transfer the information.

### How do I choose the appropriate tax return form?

All taxpayers can use Form 1040. Individuals must meet certain requirements to use Form 1040EZ or Form 1040A.



**TaxWise Hint:** If you are e-filing the tax returns, the IRS does not care which form is used. You may determine the easiest form for the taxpayer's benefit. This information is displayed at the top of the Main Information Sheet.

### Form 1040EZ

Of all the tax return forms, Form 1040EZ is the simplest. The one-page form is designed for individuals who file as either Single or Married Filing Jointly and who have no dependents. Most individuals who can be claimed as a dependent on another taxpayer's return use Form 1040EZ.

#### example

Trudy, a single 22-year-old full-time college student, is claimed as a dependent on her mother's tax return. Last year Trudy grossed \$6,100 from her part-time job as an administrative assistant. Trudy should use Form 1040EZ.

### Form 1040A

Form 1040A is a two-page form. Page 1 shows the filing status, exemptions, income, and adjusted gross income. Page 2 shows standard deduction, exemption amount, taxable income, tax, credits, payments, amount owed or refund, and signature.

Form 1040A may be filed with certain schedules. Turn to the Which Form to File chart (Tab A) of the Volunteer Resource Guide to see which types of schedules can be filed with a Form 1040A.

### example

Ramon and Julia are married and have two dependents. They will file Married Filing Jointly. Their sources of income include salaries from their jobs, Ramon's pension, and Julia's IRA. Their combined taxable income was \$65,000 for the tax year. Ramon and Julia can file Form 1040 or 1040A, however, Form 1040A is recommended.

## Form 1040

Form 1040 is a two-page form that contains all the entries on Form 1040A plus entries for more types of income, itemized deductions, and other taxes. Form 1040 provides schedules for reporting these various types of income and deductions.

Taxpayers whose taxable income exceeds \$100,000 or who have self-employment income must use form 1040.

### example

Cynthia is divorced and will file as Head of Household. She has two children she will claim as dependents. She owns a medical transcription business and earned \$35,000 in taxable income for the tax year. She plans to itemize her deductions. Cynthia will file Form 1040.

## Which tax form do I select?

When filling out a paper tax return, you can refer to the Tab A, Which Form to File? table in the Volunteer Resource Guide as you interview the taxpayer.

When using TaxWise, always select Form 1040 from the Main Information Sheet. Based on the information you enter when completing the return, the program will tell you the simplest form to use. All returns filed electronically are transmitted in the same format regardless of the form selected.

### TIP

For taxpayers who filed Form 1040EZ or Form 1040A the previous year, determine whether their situation has changed. It may be to their advantage to file Form 1040 if additional adjustments or deductions will result in a lower tax!



## EXERCISES (continued)

Using the Volunteer Resource Guide, answer the following questions.

**Question 5:** Lenny and Lisa are filing a joint return and have no dependents. Their combined income was \$31,000, which included \$35 in taxable interest and two months of unemployment income for Lisa. They want to take the standard deduction. Which is the simplest form that Lenny and Lisa can use for their tax return?

**Question 6:** Ray is married, but he and his wife Stella are filing separate returns. Their combined income was \$105,000, but Ray's income was \$64,000, half of which was self-employment income. Ray is claiming only one exemption for himself, and he wants to itemize his deductions. Which is the simplest form that Ray can use for his tax return?

## How do I file a return?

A return can be filed by sending in a paper return or by using IRS electronic filing (*e-file*).



Detailed instructions for completing and filing the return are covered in the Concluding the Interview lesson.

## What is electronic filing?

IRS *e-file* is a quick and easy alternative to traditional paper returns. Most VITA/TCE volunteer sites are now set up for filing electronically using TaxWise software.

Electronic filing is faster and more accurate than traditional paper filing. With *e-filing*, taxpayers receive their refund in half the usual time, and even faster with direct deposit.



**TaxWise Hint:** From any Form 1040 line in TaxWise, click on the Help key to bring up TaxWise instructions for that line.

## How do the two filing procedures compare?

How do I file a traditional paper return?	How do I file an IRS e-file return?
Manually review all entries and check calculations.	Check the TaxWise forms tree for any red exclamation points; review corresponding forms and complete red entries.  Run diagnostics and correct errors.
Enter the site identification number in the Paid Preparer section.	TaxWise automatically enters the site identification number in the Paid Preparer section of the return.
Assemble the return with all its properly labeled forms, schedules, and attachments in the correct sequence.	TaxWise automatically assembles and labels all of the return's forms, schedules, and attachments.
Submit for quality review. <ul style="list-style-type: none"><li>• Correct errors as needed</li></ul>	Create the e-file and submit for quality review. <ul style="list-style-type: none"><li>• If needed, correct errors, re-run diagnostics, and recreate the e-file</li></ul>
Provide two copies of the tax return to the taxpayer.  Have the taxpayer sign the return.	<ul style="list-style-type: none"><li>• Print one copy of the return for taxpayer.</li><li>• Print 2 copies of Form 8879, if applicable (one for the taxpayer and one for the volunteer site).</li><li>• Have the taxpayer sign both copies of Form 8879, if applicable.</li></ul>
Provide instructions on where and when to send the tax return to the IRS.	Electronically filed returns are transmitted to the correct IRS Processing Center, usually by the Site Coordinator. The taxpayer doesn't mail anything.

## What do I tell taxpayers about record keeping?

Taxpayers should keep a copy of the tax return, worksheets used, and records of all items appearing on it (such as 1099 forms) until the statute of limitations runs out for that return. Usually, this is the later of:

- Three years from the date the return was due or filed, or
- Two years from the date the tax was paid

Taxpayers should keep:

- Forms W-2 until the Social Security Administration has recorded the earnings reflected on the forms
- Property records (including those on a home) as long as they are needed to figure the basis of the original or replacement property
- Closing statements for a home until the home is sold
- Brokerage statements showing the purchase price of stock until the stock is sold
- Contributions to nondeductible IRAs until all IRA funds are withdrawn
- Calculations determining the nontaxable portion of pension income until all of the pension income is taxable



For additional record keeping information, see Publication 552, Recordkeeping for Individuals.

## How do I answer taxpayers' administrative questions?

The Volunteer Resource Guide and Publication 17 contain the answers to many administrative questions that are asked by taxpayers during the interview process.

Such questions as: "How can I get a copy of my prior year's return" or, "How can I get a copy of an IRS form or publication" can be answered by researching your reference materials.

Turn to the "Frequent Taxpayer Inquiries" located at the back of the Volunteer Resource Guide and review this helpful information. For a list of phone numbers you can provide to taxpayers, refer to the bottom portion of the "Contact Information for Volunteers," located on the back of the Volunteer Resource Guide,

Review the index in the back of Publication 17 and locate the answers to the taxpayers' inquiries for questions not answered in the Volunteer Resource Guide,



### EXERCISES (continued)

Using your reference materials, answer the following question.

**Question 7:** A taxpayer wants to know what the Presidential Election Campaign Fund is. Where can you find that information?

Additional information on a variety of topics can be obtained by contacting the IRS at 1-800-829-1040, accessing their web site at [www.irs.gov](http://www.irs.gov), or by visiting an IRS Tax Assistance Center in your area.

## What potential pitfalls should I keep in mind?

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Remember:

- Always treat the information used to prepare an individual's income tax return as confidential.
- Canadians have a number that is like a social security number, but it is for their old age pension. Do not use this number on a U.S. tax return. Canadians often have both a U.S. and a Canadian social security number.
- Many taxpayers erroneously report amounts from Form 1099-MISC, Miscellaneous Income, with wages or other income. Income from box 7 of the Form 1099-MISC generally should be reported on Schedule C or C-EZ and on Schedule SE, Self-Employment Tax. If the income is reported incorrectly, the IRS may later issue a notice of proposed tax increase for the self-employment income and tax.
- Be alert to the following possible indications of fraudulent activity:
  - A Form W-2 that is typed, handwritten, or has noticeable corrections
  - A Form W-2 from a company that looks different from other Forms W-2 issued by the same company
  - A suspicious person accompanying the taxpayer and observed on other occasions
  - Multiple refunds directed to the same address or P.O. box
  - Employment or earnings, which are a basis for refundable credits, that are not well documented
  - Similar returns (e.g., same amount of refund, or same number of dependents, or same number of Forms W-2)

Notify your site coordinator if you suspect any fraudulent or unusual activity.

## Which forms and documents need to be filed?

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Turn to the chart that lists the forms, types of income, and the line item entries for both Form 1040 and TaxWise, (Tab 2) in the Volunteer Resource Guide.



**TaxWise Hint:** Once the main information and income statements are entered, TaxWise automatically makes available most forms and applicable schedules. These credit forms and schedules will be annotated with a red exclamation point. The volunteer must still be alert to other deductions and credits (such as Hope and Lifetime Learning Credits, and retirement savings contribution credit if there is only a Roth IRA contribution).



Go to Appendix A-1 to determine if Vanessa has a filing requirement and verify her identity.

## Summary

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### Who must file?

To determine whether an individual is required to file a federal tax return:

- Obtain the person's age
- Calculate the person's approximate gross income
- Determine the person's likely filing status
- Use the table and guidelines in the Who Must File section of the Volunteer Resource Guide (Tab A)

### How do I verify taxpayer identity?

Before entering the taxpayer's identity information in the TaxWise Main Information Sheet or the appropriate tax return form, first verify the identity of the taxpayer(s), the accuracy of each SSN (or ITIN), and spelling of names with the appropriate documents.

### Which tax return form should I use?

The three federal tax return forms are Form 1040EZ, Form 1040A, and Form 1040.

When completing a paper tax return, refer to the Which Form Should I Use? table in the Volunteer Resource Guide, Tab A.

When using TaxWise, always select Form 1040 from the Main Information Sheet. After you have completed the return, the Main Information Sheet will tell you the simplest form you can use to print the return.

### Filing the Return

Most VITA/TCE volunteer sites are now set up for filing electronically using TaxWise software. E-filing is faster and more accurate than traditional paper filing, and taxpayers receive their refund in half the usual time.

### Record Keeping Requirements

Taxpayers should keep a copy of the tax return, worksheets used, and records of all items appearing on it (such as Forms 1099) until the later of:

- Three years from the date the return was due or filed, or
- Two years from the date the tax was paid

Refer to Publication 552, Recordkeeping for Individuals, for more information.



**Answer 7:** The index in Publication 17 directs us to a paragraph in the chapter on Filing Information.

## This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible. The paper has a slight shadow on the right side, suggesting it's resting on a surface.



## Introduction

This lesson will help you determine the most advantageous (and allowable) filing status for the taxpayer. Selecting and entering the correct filing status is a critical component of completing the taxpayer's return. First, determine the taxpayer's marital status on December 31st of the tax year. This determination will guide you to the proper filing status after further interview questions. Refer to the approved intake and interview sheet for information to help you make this determination.

**Election Campaign** ▶ Check here if you, or your spouse if filing jointly, want \$3 to go to this fund (see page 12) ▶ You ☐ Spouse ☐

**Filing Status** Check only one box.

1 <input type="checkbox"/> Single	4 <input type="checkbox"/> Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
2 <input type="checkbox"/> Married filing jointly (even if only one had income)	5 <input type="checkbox"/> Qualifying widow(er) with dependent child (see page 14)
3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶	

Be sure you are not claiming yourself. If someone can claim you as a dependent, do not check box 6a.

**Boxes checked** on 6a and 6b

Reporting of the correct filing status is handled differently, depending on which tax form you use:

- Form 1040 or Form 1040A: check the box for taxpayer's filing status in the Filing Status section.
- Form 1040EZ: does not require an entry for filing status. Use it only for taxpayers filing as Single or as Married Filing Jointly with no dependents.

To determine a taxpayer's filing status, use the interview techniques and tools discussed in the Interview lesson. See the Volunteer Resource Guide (Tab B) for the Determination of Filing Status decision tree and the Interview Tips for helpful probing questions.

## Objective

At the end of this lesson, using your resource materials, you will be able to:

- Determine the most advantageous (and allowable) filing status for the taxpayer

## What are the five filing statuses?

Taxpayers must file using one of five filing statuses. Filing status impacts the calculation of income tax, affects the amount of the standard deduction, and determines allowance or limitation of certain credits and deductions. The following list puts them in order from the most beneficial to the least beneficial to the taxpayer.

- Married Filing Jointly
- Qualifying Widow(er) with Dependent Child
- Head of Household

### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17

### Optional:

- ☐ Publication 501
- ☐ Publication 555
- ☐ Publication 971
- ☐ Form 1040
- ☐ Form 8379

### TIP

Taxpayers may qualify for more than one filing status. Choose the filing status that results in the lowest tax (most beneficial) for the taxpayer. Use the Volunteer Resource Guide (Tab B) to help determine the correct filing status(es).

- Single
- Married Filing Separately



**TaxWise Hint:** Filing status is selected on the Main Information Sheet in TaxWise. See the Main Information Sheet in the Volunteer Resource Guide (Tab 1) Starting TaxWise.

### How does marital status affect filing status?

The first step in determining the taxpayer's filing status is to confirm their marital status *on the last day of the tax year*. Avoid using the information from the prior year as it may have changed.

Generally, taxpayers are considered to be **unmarried** for the entire year if on the last day of the tax year:

- They were unmarried, **or**
- They were legally separated, under a separate maintenance decree, **or**
- They were divorced under a final decree on or before December 31 of the tax year

Taxpayers are considered to be **married** for the entire year if:

- They were married on the last day of the tax year, **or**
- The spouse died during the year and the surviving spouse has not remarried

### What are the requirements for each filing status?

There are different requirements for each filing status.

#### Who is considered Single?

Taxpayers can use the Single filing status if, on the last day of the tax year, they were:

- Not married, or
- Legally separated or divorced, or
- Widowed before the beginning of the tax year and did not remarry

#### Can Single filers qualify for another status?

Some single taxpayers qualify for Head of Household or for Qualifying Widow(er) with Dependent Child status, which can mean a lower tax.

#### What is Married Filing Jointly?

Married taxpayers who choose to file a joint return will use one return to report their combined income and to deduct combined allowable expenses. Married taxpayers can select this status even if one of the spouses did not have any income or any deductions. The Married Filing Jointly status can be claimed by taxpayers who, on the last day of the tax year:



Avoid selecting a filing status that results in a higher tax for the taxpayer. For example, Single filers with a qualifying person may qualify for Head of Household, which often results in a lower tax. The rules for who is a qualifying person will be addressed later in the lesson under Head of Household.

- Were married and lived together as husband and wife, or
- Were married and living apart, but were not legally separated or divorced, or
- Lived together in a common law marriage that is recognized in the state where they currently live or the state where the common law marriage began, or
- Did not remarry after their spouse died during the year



A citizen or resident alien married to a non-resident alien may be able to file a joint return. More information can be found in the Military Filing Status section of this publication.



The rules around common-law marriages are complex and differ from state to state. As a volunteer, it is not your responsibility to determine whether a couple is involved in a common-law marriage. If a taxpayer is not certain, refer him/her to a professional tax preparer.

### ***What are the responsibilities of each taxpayer on a joint return?***

Both taxpayers must include all worldwide income on their joint return. They each may be held responsible for all the tax and for any interest or penalty due, even if all the income was earned by only one spouse. A subsequent divorce usually does not relieve either spouse of the liability associated with the joint return.

In some cases, a spouse may be relieved of joint liability. This topic is beyond the scope of the VITA/TCE Program. The volunteer would need to refer the taxpayer to a professional tax preparer. For more information, see Publication 971, Innocent Spouse Relief. This publication can be downloaded from the [www.irs.gov](http://www.irs.gov) web site.

### **What is Married Filing Separately?**

The Married Filing Separately status is for taxpayers who qualify as “married” under the definition provided above, and either:

- Choose to file separate returns, or
- Cannot agree to file a joint return

Taxpayers who file as Married Filing Separately will each report their own income and deductions on separate returns. These rules do not apply in community property states. More information on community property appears later in this lesson.

### ***Can Married Filing Separately filers qualify for another status?***

Some married taxpayers may qualify as “unmarried,” according to the IRS definition of “unmarried,” even if they are not divorced or legally separated. Such taxpayers may be able to use the Head of Household filing status. Filing as Head of Household may result in a lower tax than Married Filing Separately. Refer to the What is Head of Household: Can married taxpayers ever file as Head of Household? section of this lesson to see if the “unmarried” definition applies.

### ***Why are taxes usually higher for Married Filing Separately?***

Special rules apply to taxpayers who file Married Filing Separately. These generally result in the taxpayer paying a higher tax. For example, when filing separately:

- The tax rate is generally higher than on a joint return.
- Taxpayers cannot take credits for child and dependent care expenses, earned income, and certain adoption and education expenses.
- Some credits and deductions are reduced at income levels that are half those for a joint return such as the child tax credit, retirement savings contribution credit, itemized deductions, and the deduction for personal exemptions.

If one spouse filing MFS is itemizing, the other spouse, if filing MFS, must itemize or take a standard deduction of zero.



The question of who is itemizing only comes into consideration when both taxpayers are filing as Married Filing Separately. If one spouse qualifies to file as Head of Household, the fact that the other one is filing as Married Filing Separately and is itemizing doesn't apply.

For the complete list of special rules see Publication 17, Filing Status chapter.

### ***Are there special rules for taxpayers who live in community property states?***

The income of taxpayers who lived in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin during the tax year and wish to file separate returns may be considered as separate income or community income for tax purposes. Each state has its own community property laws. See Publication 555, Community Property, for more information.

If your local tax assistance program views community property tax laws for Married Filing Separately filers as beyond the scope of the program, refer such taxpayers to a professional tax preparer.

When Married Filing Separately, you must enter the other spouse's name and social security number or ITIN on the tax return. This is explained in Form 1040 Instructions for line 3.



**TaxWise Hint:** Go to the Volunteer Resource Guide (Tab 1), Starting TaxWise. Find the section of the Main Information Sheet that addresses filing status. Notice the questions asked of the taxpayer filing Married Filing Separately. If the taxpayer is in one of the community property states mentioned on the form, additional questions must be answered. You may have to complete a worksheet entitled Allocation of Income for Community Property Income.

### ***If filing jointly generally results in the lowest total tax, why would married taxpayers want to file separately?***

Married taxpayers sometimes choose to file separate returns when one spouse does not want to be responsible for the other spouse's tax obligations; or because filing separately may result in a lower total tax. For example, if one spouse has high medical or miscellaneous expenses, or large casualty losses, separate returns

may result in lower total taxes because a lower adjusted gross income allows more expenses or losses to be deducted.

Another common reason taxpayers file as Married Filing Separately is to avoid an offset of their refund against their current spouse's outstanding prior debt. This includes things such as past due child support, past due student loans, or a tax liability the current spouse incurred when they were not married to each other.

If a taxpayer tells you he or she wants to file separately, ask the taxpayer why they want to elect this status. If a potential offset is the reason, this is the perfect time to educate the taxpayer about the possibility of avoiding at least their share of the refund offset and attaching a Form 8379, Injured Spouse Allocation. See the Publication 17 Index, keyword: "Injured Spouse" for additional information. The Form 8379 instructions are also very informative. This form can be e-filed.

Be aware of community property law requirements; these laws may affect the amount of tax owed by taxpayers living in community property states.

### ***What if a spouse died during the tax year?***

Remember, taxpayers whose spouses have died during the tax year are considered married to that spouse for the entire year, providing the surviving spouse has not remarried. The surviving spouse is eligible to file as Married Filing Jointly or Married Filing Separately.

If the surviving spouse has remarried:

- He or she must file either jointly with the new spouse (Married Filing Jointly) or separately from the new spouse (Married Filing Separately)
- The deceased spouse's filing status becomes Married Filing Separately

Determine the most advantageous filing status for the taxpayer. Surviving spouses who have a dependent child may be able to use the Qualifying Widow(er) with Dependent Child status in the two tax years following the year of the spouse's death. This is discussed in a subsequent section.

### **Who is Head of Household?**

Taxpayers may choose the Head of Household filing status, if they:

- Are unmarried or "considered unmarried" but are not a qualifying widow(er) with dependent child on the last day of the tax year, *and*
- Paid more than half the cost of keeping up a home during the tax year, *and*
- Had a qualifying person living in their home for more than half the year (except for temporary absences such as school)

For a married taxpayer to be "considered unmarried," the taxpayer must also have a child who is claimed as a dependent. (Exception: if the only reason the taxpayer is not claiming an exemption for the child is because the noncustodial parent can claim the exemption, this requirement is met.)

Taxpayers may also choose the Head of Household filing status if they are not married and maintain a home for their parent(s). This home must be the principal place of abode for the parent(s), but it does not have to be the same home as that of the taxpayer. The parent(s) must qualify as the taxpayer's dependent(s).

### **Who is a qualifying person for Head of Household status?**

Turn to the Volunteer Resource Guide (Tab B), Filing Status. Look at the decision tree on the page titled Determination of Filing Status.

A qualifying person is defined as:

- A Qualifying Child
- A married child who can be claimed as a dependent
- A dependent parent
- A “qualifying relative” who lived with the taxpayer more than half the year and is one of the relatives listed in the Volunteer Resource Guide Interview Tips for Dependency Exemption for Qualifying Relative under Step 1 only



A person may qualify as a “qualifying relative” dependent, but not qualify the taxpayer for Head of Household filing status.

For a married taxpayer, the qualifying person for Head of Household must be the taxpayer’s dependent child. (Exception: the noncustodial parent rule.)



### **EXERCISES**

Answers are after the lesson summary.

**Question 1:** Alexandra’s younger brother, Sebastian, is seventeen years old. Sebastian lived with some friends from January-February of 2008. From March-July of 2008, he lived with Alexandra. August 1, Sebastian moved back in with his friends, with whom he stayed for the rest of the year. Since Sebastian did not have a job, Alexandra gave him money every month. Assuming Alexandra had no other dependents, can she file as “Head of Household” for 2008? ☐ Yes ☐ No

Notice that the relatives that qualify a person for Head of Household may not be the same relatives that could qualify a taxpayer for a dependency exemption.

### **example**

Since Joan’s husband died 5 years ago, she has lived with her friend, Mary Ann. Joan is a U.S. citizen, single, lived with Mary Ann all year, had no income and received all of her support from Mary Ann. Mary Ann is a widow also. No one can claim Mary Ann as a dependent on their return. Joan falls under the definition of a “qualifying relative” and Mary Ann can claim Joan as a dependent on her return.

However, Joan would not qualify Mary Ann for Head of Household purposes, because she does not fall under the “other relative” definition stated in the Volunteer Resource Guide (Tab B), Filing Status.

When you get to Step 7 on the Interview Tips for Filing Status in the Volunteer Resource Guide, be sure to refer to the definitions of a qualifying person on the previous page if you have any questions.



The qualifying person for Head of Household filing status is always related to the taxpayer.

For Head of Household, a Qualifying Child does not have to be a dependent of the taxpayer. (Exception: a married taxpayer considered unmarried for Head of Household purposes.)

If the child is *not* the taxpayer's dependent, enter the qualifying child's name on line 4 of Form 1040 or Form 1040A. Only enter one child's name.



**TaxWise Hint:** Turn to Tab 1, Starting TaxWise, in the Volunteer Resource Guide. Find the Main Information Sheet that shows the filing status section. TaxWise requires you to enter the child's name and social security number.

### ***What are the advantages of filing as Head of Household?***

The Head of Household filing status provides a higher standard deduction and, generally, a lower tax rate than Single or Married Filing Separately.

### ***Can married taxpayers ever file as Head of Household?***

Married taxpayers may be “considered unmarried” and file as Head of Household if they meet the tests for married persons living apart with dependent children. Taxpayers are considered “unmarried” and can file as Head of Household if they:

- File a return, separate from their spouse, for the tax year. If a joint return has been filed, the filing status cannot be changed if the due date of the return has passed.
- Have paid more than half the cost of keeping up their home for the tax year. See Publication 17: Filing Status: Head of Household for the Cost of Keeping Up a Home worksheet.
- Have lived apart from their spouse during the entire last 6 months of the tax year. The spouse is considered to have lived in the home even if temporarily absent due to special circumstances, such as military service or education.
- Have provided their home as the main home of their dependent child, stepchild, adopted child, or foster child placed by an authorized agency for more than half the year. Certain exceptions exist. To find details, see Publication 17: Personal Exemptions and Dependents: Exemptions for Dependents: Children of divorced or separated parents.

Taxpayers who are legally separated from their spouse under a divorce or separate maintenance agreement are considered single. They can file as Single, or they might qualify for Head of Household. They would have to meet the same rules as a Single person would for Head of Household.

A taxpayer who is married to a nonresident alien spouse may be able to file as Head of Household even though they have lived together during the year. This information can be found in the Military Filing Status chapter.



## Who is a Qualifying Widow(er) with Dependent Child?

A taxpayer, whose spouse died in one of the two tax years prior to 2008 (either 2007 or 2006 ) and who has one or more dependent children, may claim the Qualifying Widow(er) with Dependent Child status. To qualify, the taxpayer must:

- Be entitled to file a joint return for the year the spouse died, regardless of whether the taxpayer actually filed a joint return that year.
- Have had a spouse who died in 2006 or 2007. The taxpayer must not have remarried before the end of 2008.
- Have a child, stepchild, or adopted child who qualifies as the taxpayer's dependent for the year.
- Have furnished over half the cost of keeping up a home for himself/herself and the qualifying child for the entire year, except for temporary absences.



A foster child does not qualify a taxpayer for the Qualifying Widow(er) with dependent child filing status.

In the year a taxpayer's spouse dies, if the taxpayer does not remarry, the Married Filing Jointly filing status can be used with the deceased spouse.

Taxpayers may be able to use the Qualifying Widow(er) with Dependent Child filing status for two years following the year of death, provided they do not remarry.

The standard deduction and tax tables are the same for Qualifying Widow(er) with Dependent Child filing status as for Married Filing Jointly filing status. These are more favorable than those for Head of Household filing status.

### example

Laura, whose husband Jim died in September of the tax year, has not remarried, and provides all the support for her two dependent children, ages 7 and 9. Laura can file Married Filing Jointly, claiming an exemption for her deceased husband. The next two years she can use the Qualifying Widow(er) with Dependent Child status if she has not remarried.



**TaxWise Hint:** Turn to Tab 1, Starting TaxWise, and locate the Main Information Sheet that includes the filing status section. For Qualifying Widow(er) filing status, you must enter the deceased spouse's year of death on the TaxWise Main Information Sheet. Also, "Name line 2" must be completed on the Main Information Sheet. Type the name of the person filing the return. There is no place to enter the year of death on a paper return.

## How do I determine the correct filing status?

To determine the best filing status, follow the Interview Tips and the Determination of Filing Status flow chart in the Filing Status section of the Volunteer Resource Guide (Tab B). Then enter the filing status on the approved intake and interview sheet.





## EXERCISES (continued)

Check your understanding of each filing status. Feel free to review the lesson if you are not sure of an answer and use the Volunteer Resource Guide (Tab B). The answers are at the end of the lesson.

**Question 2:** Jane's husband died in 2008. She and her husband qualified to file a joint return in 2007, but they did not. Jane's children are grown and they maintain households of their own. She has not remarried. What filing status(es) can she use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child

**Question 3:** Seth lives alone and has never married. He does not support either of his parents. What filing status(es) can he use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child

**Question 4:** Tanya's divorce became final in early September of the tax year. She has sole custody of her three children, who lived with her the entire year. The children are all under the age of 19. She provided more than half of the cost of keeping up the home. What filing status(es) can she use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child

**Question 5:** Sydney's wife died in January of 2006. He filed a joint return for that year as the surviving spouse. In 2008, Sydney, who has not remarried, still maintains a home for his young children all year, and he provides their sole support. What filing status(es) can he use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child



## EXERCISES (continued)

**Question 6:** An earlier question referred to Sydney, whose wife died in January 2006. He filed a joint return for that year as the surviving spouse. In 2008, Sydney, who did not remarry, maintained a home for his young children, and he provided their sole support. We determined that he could file as Single, Head of Household or Qualifying Widow(er) with Dependent Child. Go back to the Interview Tips and use them to identify the recommended filing status for Sydney. Outline the answers to the interview steps. What filing status should he use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child

## Practice – Vanessa Franklin

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-6 to determine the most appropriate filing status for her.

## Summary

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This lesson covered the five filing statuses, as listed on the return, they are:

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er) with Dependent Child

If taxpayers qualify for more than one filing status, choose the one that results in a lower tax. For example, in most cases, married couples will pay less tax if they file joint returns.

In general, the Head of Household status is for unmarried taxpayers who paid more than half the cost of maintaining a home for a qualifying person during the tax year. However, some married taxpayers who live apart from their spouses during the last six months of the year and provide for dependent children may qualify to file as Head of Household.

A widow or widower with one or more dependent children may be able to use the Qualifying Widow(er) with Dependent Child filing status, which is available for two years following the year of the spouse's death.



## EXERCISE ANSWERS

**Answer 1:** No, because Sebastian only lived with Alexandra for five months, which is less than half the year.

**Answer 2:** Remember, if a spouse died during the year, and the surviving spouse did not remarry, the surviving spouse is considered to be married on December 31 for filing status purposes. You would answer YES to Step 1.

Because she was widowed in 2008 and has not remarried, Jane can file as Married Filing Jointly or Married Filing Separately. However, she is likely to pay a lower tax if she chooses Married Filing Jointly. Jane is not eligible for the Qualifying Widow(er) with Dependent Children status because those rules are in effect for the two years after the year in which the spouse has died and she must have dependent children. Note: The exercise question stated they didn't file as Married Filing Jointly in 2007, and this would be an opportunity for you to use your interview techniques to determine why they didn't. There might have been circumstances that made it more advantageous to file as Married Filing Separately, and those might still exist.

**Answer 3:** Because he is not married and has no dependents living in his household, nor does he have dependent parents, Seth can only file as Single.

**Answer 4:** Because she is legally divorced, Tanya can file as Single. However because she has children, she may be able to file as Head of Household, which may result in a lower tax.

**Answer 5:** Sydney can file as Single but he also meets the test for Head of Household and Qualifying Widow(er) with Dependent Child. Qualifying Widow(er) with Dependent Child will likely give him the lowest tax.

**Answer 6:** The Interview Tips say that he should use the Qualifying Widow(er) with Dependent Child status. The interview steps are:

- Step 1: No
- Step 5: Yes
- Step 6: Yes

[illegible]

## Introduction

This lesson will help you determine how many personal exemptions the taxpayer can claim. Claiming the maximum number of allowable exemptions will result in the lowest tax for the taxpayer.

Personal exemptions are reflected in the Exemption section of TaxWise and on page 1 of the Form 1040 series. Refer to the Volunteer Resource Guide (Tab 1) - Starting TaxWise for a display of a TaxWise entry screen.

To determine the personal exemptions that a taxpayer can claim, use the interview techniques and tools discussed in the Interview lesson. See Tab C in the Volunteer Resource Guide for the Interview Tips referenced in this lesson. They can provide helpful probing questions.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine how many personal exemptions a taxpayer can claim

### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ **Optional:** Publication 501

## What are exemptions?

An **exemption** is a dollar amount that can be deducted from an individual's total income, thereby reducing the taxable income. Taxpayers may be able to claim two kinds of exemptions:

- **Personal exemptions** generally allow taxpayers to claim themselves (and possibly their spouse)
- **Dependency exemptions** allow taxpayers to claim qualifying dependents



The exemption amounts are indexed for inflation and are generally updated every year.

This lesson discusses personal exemptions.

## When can a taxpayer claim personal exemptions?

To claim a personal exemption, the taxpayer must be able to answer "no" to the intake question, "Can you or your spouse be claimed as a dependent on the income tax return of any other person for 2008?"

This applies even if another person does not actually claim the taxpayer as a dependent. A taxpayer who could be claimed as a dependent must claim "0" exemptions. This means they won't be able to subtract the exemption amount from their gross income, and they may have to use a smaller standard deduction amount. (See the lesson entitled, Standard Deduction and Tax Computation).

If married taxpayers file a joint return, they can take personal exemptions for each spouse. If they file separate returns, they can each take a personal exemption for themselves, as long as no one else can claim them as a dependent.



Always use the Interview Tips decision tree in the Volunteer Resource Guide, Tab C to determine the number of exemptions each taxpayer can claim.

### **When can taxpayers claim an exemption for their spouse?**

A spouse is never considered the dependent of the other spouse. However, taxpayers may be able to take an exemption for their spouse simply because they are married.

To claim a personal exemption for one's spouse, the taxpayer must meet these conditions:

- Married as of December 31 of the tax year, and
- Spouse cannot be claimed as a dependent on another person's tax return, and
- Files a joint return, or files a separate return *and* the spouse had no income and is not filing a return



Taxpayers who are divorced or legally separated at the end of the tax year cannot claim their (former) spouse as an exemption. A common-law marriage is recognized for federal tax purposes if it is recognized by the state where the taxpayers currently live or in the state where the common law marriage began. Legal advice may be necessary to determine if a common-law marriage exists.



**TaxWise Hint:** If the taxpayer is married filing a separate return and is able to claim their spouse's exemption, fill in the spouse's name, SSN, and other information in the TaxWise Main Information Sheet, Dependents/Non-Dependents section, showing the relationship as "other" and the Code as "3."

### ***What about a deceased spouse?***

A taxpayer whose spouse died during the tax year can generally claim the personal exemption for the deceased spouse if the taxpayer meets all of these conditions:

- Did not remarry by December 31 of the tax year, and
- Was not divorced or legally separated from their spouse on the date of death, and
- Would have been able to claim the exemption under the general rule.

## How do I use the interview techniques to determine how many personal exemptions a taxpayer can claim?

The Interview Tips for Personal Exemptions can help determine whether the taxpayer can claim any personal exemptions. Take a look at the Interview Tips within Tab C in the Volunteer Resource Guide. While you interview the taxpayer, use these questions as a guide to help you get the information you need from the taxpayer.

## How do I enter the personal exemptions?

### Personal exemptions are claimed on line 6a and 6b of Form 1040.

On **line 6a** of the tax return, check the box next to “Yourself” if the taxpayer meets the requirements for claiming themselves as an exemption.

On **line 6b**, check the box next to “Spouse” if the taxpayer meets the requirements for claiming their spouse as an exemption.

If the taxpayer is filing as Head of Household and claiming an exemption for a nonresident alien spouse, check the box on **line 6c** and enter the spouse’s first name, last name, and SSN or ITIN.



**TaxWise Hint:** TaxWise will auto-fill the entries for lines 6a and 6b as well as for “Number of boxes checked on 6a and 6b.” TaxWise automatically checks the exemptions box for the taxpayer (and for their spouse if Married Filing Jointly status is selected). If someone else is entitled to claim the taxpayer (or spouse), check the appropriate box on line 6 of the Main Information Sheet.

## Taxpayer Example

Ray Jackson is a widower whose wife died during the 2008 tax year. Ray’s approved intake and interview sheet shows the following responses.

e-mail: \_\_\_\_\_ ☐ Yes ☐ No

16. On December 31<sup>st</sup>

a. Were you: ☐ Single ☐ Legally Married ☐ Separated ☐ Divorced ☒ Widowed

b. If married, did you live with your spouse during any part of the last six months of the year? ☐ Yes ☐ No

c. Is your spouse deceased? If yes, provide the date of death. 02/20/2008 (mm/dd/yyyy)

Part II. Family and Dependent Information – Do not include you or your spouse.

### Which personal exemptions can Ray claim?

Use the Interview Tips for Personal Exemptions within Tab C in the Volunteer Resource Guide to help you complete lines 6a and 6b on his tax return. Here’s how the conversation might sound:

## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*The questions I'm about to ask you will help us figure out if you can claim any personal exemptions. First of all, you've told me that you were married until your wife died in February. I'm sorry for your loss, sir. Did you remarry sometime during the rest of the tax year?*

*Are you filing a joint return with your late wife this year?*

*Can anyone else claim either of you as dependents?*

*Based on your answers, you can claim an exemption for yourself and for your late wife.*

[On the approved intake and interview sheet, the volunteer should check "No" for the question, "Can you or your spouse be claimed as a dependent on the income tax return of any other person in 2008?" which Ray left blank.]

### RAY RESPONDS...

No, I haven't remarried.

Yes.

Well, I don't think so. We lived off our own income.

Because Ray can claim himself and his late wife as personal exemptions, you will enter both their names and SSNs in the Main Information Sheet in TaxWise. TaxWise automatically checks the boxes on lines 6a and 6b and enters "2" for "Number of boxes checked on 6a and 6b."

You will also enter the Date of Death under the spouse in the Taxpayer Information area of the Main Information Sheet in TaxWise. If you are preparing a paper return, write "Deceased" along with the deceased spouse's name and Date of Death across the top of the return. Once you complete the Date of Death in TaxWise, the program will automatically print that notation.



**TaxWise Hint:** You must also go to Name Line 2 in the U.S. address area at the top of the Main Information Sheet and enter the name of the person filing the return for the deceased person. This may be the surviving spouse if the filing status is Married Filing Jointly or a personal representative such as an executor, administrator, or anyone who is in charge of the deceased taxpayer's property. When you print the return, TaxWise prints the date of death and DECD next to the deceased person's name in the address area at the top of Form 1040 page 1, as required by the IRS.



## Practice - Vanessa Franklin

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-8 to determine the personal exemptions she can claim.

### Summary

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There are two types of exemptions – personal and dependency. A personal exemption can be claimed for:

- The individual taxpayer, unless they can be claimed as a dependent on another person's tax return
- The taxpayer's spouse, if a joint return is filed and the spouse cannot be claimed on another taxpayer's return
- The taxpayer's spouse, if the taxpayer is not filing a joint return *and* the spouse had no income, is not filing their own return, and is not a dependent of another person

Personal exemptions are claimed on lines 6a and 6b of Form 1040.

1. If applicable, check the box for the taxpayer's own exemption on **line 6a**.
2. If applicable, check the box for the taxpayer's spouse on **line 6b**.
3. TaxWise will auto-fill the entries for lines 6a and 6b as well as for "Number of boxes checked on 6a and 6b."
4. If someone else is entitled to claim the taxpayer (or spouse), check the appropriate box on line 6 of the TaxWise Main Information Sheet.
5. If the taxpayer is filing as Head of Household and claiming an exemption for a nonresident alien spouse, check the box on **line 6c** in TaxWise and enter the spouse's first name, last name, and SSN or ITIN.

[illegible]

## Introduction

This lesson will help you determine how many exemptions a taxpayer can claim for dependents. Claiming the maximum number of allowable exemptions will result in the lowest tax for the taxpayer.

TaxWise determines the taxpayer's dependency exemptions based on the Dependents/Nondependents information entered on the TaxWise Main Information Sheet.

To determine the dependency exemptions, use the interview techniques and tools discussed in the Screening and Interviewing lesson. See Tab C of the Volunteer Resource Guide for the Interview Tips shown in this lesson. It can provide helpful probing questions.

When the interview is complete, the results are documented on the approved intake and interview sheet. This information will be the basis of your entries in TaxWise.

## Who are dependents?

A dependent is a person, other than the taxpayer or the taxpayer's spouse who meets the definition of qualifying child or qualifying relative. Some examples of dependents include:

- Child
- Stepchild
- Brother
- Sister
- Parent

### TIP

Persons who qualify to be claimed as a dependent may file a return for taxes withheld, but they cannot claim any exemptions.

A taxpayer can claim one exemption for each qualified dependent, thereby reducing the taxable income.

## Objective

At the end of this lesson, using your resource materials, you will be able to:

- Determine how many exemptions a taxpayer can claim for dependents.

### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17

#### **Optional:**

- ☐ Publication 501
- ☐ Form 2120
- ☐ Form 8332

## Who may be claimed as a dependent?

A dependent may be either a "Qualifying Child" or a "Qualifying Relative." The requirements for both have much in common, but there are some tests that are specific to Qualifying Child or Qualifying Relative.

### TIP

The tests for Qualifying Relative are applied only when the tests for Qualifying Child are not met.

In addition to the tests specific to Qualifying Child and Qualifying Relative, all of the following tests must be met for both:

- Dependent taxpayer test
- Joint return test
- Citizen or resident test

Use caution when preparing this section of the taxpayer's return. The Interview Tips in the Exemptions section of the Volunteer Resource Guide (Tab C) cover the requirements for all the dependency tests. Avoid using information from the taxpayer's prior year documents to complete this section.

## How do I apply the dependency tests?

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The Family and Dependent Information section of the approved intake and interview sheet addresses the issues concerning dependency, but you will still need to use your interview skills to clarify whether the individuals listed are eligible to be claimed as dependents.

Use Tab C of the Volunteer Resource Guide to help you ask probing questions to verify the information on the approved intake and interview sheet. Use the Interview Tips to apply the dependency tests.



A taxpayer's spouse *cannot* be claimed as a dependent but can be claimed as a personal exemption.

## Does it matter if I use the Interview Tips?

If you are a new or returning volunteer, the Interview Tips provide guidelines and definitions to help you apply the dependency tests. The Interview Tips incorporate all of the exceptions allowed for the Support Test. Use the Interview Tips for the Support Test if the dependent is:

- A child with divorced or separated parents (or never married), or
- Supported by two or more people who together provide more than half the dependent's support (Multiple Support)

## How do I use the Interview Tips?

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One way to apply the dependency tests is to refer to the Interview Tips for each dependency test.

## What are the tests for Qualifying Children?

To determine if the taxpayer has a dependent, begin by applying the rules for a Qualifying Child. If these tests are not met, then you can continue on to the tests for a Qualifying Relative. Remember, a dependent may be either a Qualifying Child or a Qualifying Relative to be claimed as a dependent.

## Relationship

Review step one of the Interview Tips in your Volunteer Resource Guide, Tab C, Table 1.

The first step is determining if the child is related to the taxpayer in one of the following ways:

- The taxpayer's child, stepchild or adopted child, or their descendant (grandchild)
- The taxpayer's brother, sister, stepbrother, stepsister or their descendant (niece or nephew)
- A foster child placed with the taxpayer by an authorized placement agency or court order

## Age

The next step is determining the child's age. Review step two of the Interview Tips in your Volunteer Resource Guide.

The child must be at least one of the following:

- Under age 19 at the end of the tax year
- Under age 24 and a full-time student (as defined by the school) for at least 5 months of the year
- Permanently and totally disabled at any age



To be considered a student, the taxpayer's child must attend school full time (as determined by the school) for some part of each of five calendar months of the year. School generally does not include night schools, on-the-job training courses, or correspondence schools.

## Support

Step three of the Interview Tips and the Worksheet for Determining Support, in the Volunteer Resource Guide, determines the level of support. A child cannot have provided more than half of his/her own support during the tax year.

### example

Bob is 22, a full-time student and lives at home with his parents when he is not in the dorm. He worked part-time and made \$6,000, but that was not over half of his total support. Bob meets the relationship, age, and support tests. If he meets the rest of the tests for a qualifying child, he can be claimed as a dependent by his parents.

### example

Doris is 8 years old and had a small role in a television series. She made \$60,000 during the tax year, but her parents put all the money in a trust fund to pay for college. She lived at home all year. Doris meets the relationship, age, and support tests. If she meets the rest of the tests for a qualifying child, she can be claimed as a dependent by her parents.

## Residence

Step four of the Interview Tips examines residency. The child must have the same principal residence as the taxpayer for more than half the year. The child is considered to have the same place of residence as the taxpayer even if the child (or the parent) is temporarily absent due to special circumstances such as education, illness, vacation, business, or military service.

### ***Special Exceptions for the Residence Test***

Taxpayers may claim an exemption for a child who has been kidnapped, a child who was born alive at any time during the year and then died, or any other dependent that died during the year, as long as the dependent meets other dependency tests.

#### **example**

Hugh's daughter died on January 15 of the tax year. If she met all the dependency tests up until her death, Hugh can claim an exemption for her on his return.

A taxpayer may *not* claim dependency exemptions for a housekeeper, other household employee, or for a stillborn child.

Refer to the Personal Exemptions and Dependents chapter of Publication 17 for detailed information regarding the residency test.

Special rules that apply to custodial and non-custodial parents will be discussed later in this lesson.

### **Additional Rules**

The first four steps covered above apply specifically to Qualifying Children. The next five Interview Tips cover additional rules for considering a Qualifying Child as a dependent. Some of these steps will also apply when we talk about Qualifying Relatives.

#### ***U.S. Citizen or Resident***

Step 5 is sometimes referred to as the citizen or resident test. Do not get it confused with step 4 which refers to who the child is living with (residency test). To pass the citizen or resident test, the dependent must be either a U.S. citizen or resident of the U.S., Canada or Mexico. Note that:

- Children are usually citizens or residents of the country in which their parents are citizens. So, if either parent is a U.S. citizen, a child born in a foreign country can be recognized as a U.S. citizen for tax purposes.
- If a U.S. taxpayer legally adopts a child who is not a U.S. citizen or resident, this test is met as long as the child lives with the taxpayer as a member of the household all year. If all the other dependency tests are met, the taxpayer can claim the child as a dependent.
- Foreign exchange students generally are not U.S. residents and do not meet the citizen or resident test, so they cannot be claimed as dependents.

#### **example**

Joan, who is a U.S. citizen, adopted an infant boy from Cambodia who has lived with her for the entire tax year. Even though Joan's child is not yet a U.S. citizen or resident, he meets the Citizen or Resident Test because he was a member of Joan's household for the entire year.

## ***Joint Return***

Look at steps 6 and 7 in the Interview Tips of the Volunteer Resource Guide. To pass the joint return test, the dependent must *not* file a joint return for the year, unless:

- The joint return is filed only to claim a refund of taxes withheld, and
- No tax liability would exist for either spouse on separate returns

### **example**

Ruth had no income. She married in November of the tax year. Ruth's husband had \$16,700 income and they claimed two personal exemptions on their return. Even though Ruth's father supported her and paid for the wedding, he cannot claim her as a dependent because she is filing a joint return with her husband.

## ***Qualifying Child of More Than One Person***

Review step 8 and the associated footnotes in the Volunteer Resource Guide. It is possible for a child to meet the relationship, age, residency, and support tests to be a qualifying child of more than one person, but the dependency exemption can only be claimed on one tax return. The taxpayers can decide who can claim the exemption, but only the taxpayer claiming the exemption can claim other tax benefits that require a Qualifying Child, such as the earned income credit, child tax credit, credit for child and dependent care, and Head of Household filing status. Additional rules or age restrictions must be applied to determine if the taxpayer is eligible for these tax benefits.

If the Qualifying Child is actually claimed on more than one tax return in a given year, the IRS will apply the tie-breaker rules listed within Tab C in the Volunteer Resource Guide.

## ***Dependent Taxpayer***

The final interview question for a Qualifying Child is step 9, within Tab C in the Volunteer Resource Guide. Look at the question on the taxpayer's approved intake and interview sheet that asks "Can your parents or someone else claim you or your spouse as a dependent on their tax return?" To claim a dependency exemption, a taxpayer cannot be a dependent on another person's tax return. If a taxpayer can be claimed as a dependent by another person, the taxpayer may not claim anyone else as a dependent, even if the taxpayer has a Qualifying Child or Qualifying Relative.

## ***What are the tests for Qualifying Relatives?***

Dependents who do not meet the tests for Qualifying Child might meet the slightly different tests to be a Qualifying Relative. The four tests are Member of Household or Relationship Test, Qualifying Child of Another Taxpayer Test, Gross Income Test, and Support Test. Turn to the Interview Tips for Qualifying Relative in your Volunteer Resource Guide (Tab C).

### ***Relationship or Member of Household***

The dependent must be related to the taxpayer (or spouse on a joint return) in one of the ways listed in step 1 of the Interview Tips. It is important to note that a close relative of the taxpayer does not have to live in the same household to meet this test.

#### example

Susan and Ted are married and file a joint return. They have supported Ted's parents for the majority of the tax year. Even though Ted's parents do not live with Ted and Susan, Ted's parents meet the member of household or relationship test because they are qualifying relatives.

An unrelated person that lived with the taxpayer for the entire year can also meet the member of household or relationship test. Step 2 probes to determine if the person is an individual (other than a spouse) who had the same principal place of abode as the taxpayer and was a member of the taxpayer's household for the entire year, regardless of relationship. If the relationship violates local laws, this test is not met. For example, if the taxpayer's state prohibits cohabitation, then that person cannot be claimed, even if all other criteria are met.

Note that:

- Temporary absences due to illness, education, business, vacation, military service, and placement in a nursing home are acceptable
- A relationship established by marriage, such as "mother-in-law" or "sister-in-law," does not end with divorce or death of a spouse; that means they are Qualifying Relatives even if they do not live with the taxpayer
- Cousins can meet the relationship test for Qualifying Relative *only if* they live with the taxpayer for the entire year
- Unlike Qualifying Children, Qualifying Relatives (Step 1) do *not* have to live with the taxpayers in order to be claimed as a dependent; however, an unrelated individual (Step 2) must live with the taxpayer for the full year

The Interview Tips, steps 1 and 2, for Dependency Exemptions can help you determine if a person passes the Qualifying Relative Member of Household or Relationship Test.

#### ***Not the Qualifying Child of Another Taxpayer***

A child is not considered your qualifying relative if the child is your qualifying *child* or is the qualifying child of *another* taxpayer.

A child may qualify as your dependent under the tests for Qualifying Relative, even if that child is the Qualifying Child of another taxpayer. This is allowed only when the other taxpayer is not required to file an income tax return, and does not file an income tax return or only files a return to get a refund of income tax withheld.

Special rules that apply to custodial and noncustodial parents will be discussed later in this lesson.

#### example

Todd has lived with his girlfriend, Eva, and her two children all year in his home. Eva is not required to file a 2008 tax return, and does not file a 2008 tax return. Todd has provided more than half of their support for the entire year. Eva and her two children are Todd's qualifying relatives because they meet the Member of Household or Relationship Test, Gross Income Test, and Support Test. (Eva and Todd's relationship does not violate local laws.)



#### example

All the facts are the same as in the previous example, except that Eva is required to file a tax return. She still meets all the tests to be Todd's Qualifying Relative dependent. Since Eva has a filing requirement and her children meet the tests to be Eva's qualifying child dependents, Todd can no longer claim the children as Qualifying Relative dependents. He can still claim Eva as a dependent, and Eva may not claim herself or any dependents on her own.

#### example

Since late in 2007, Sally has been supporting her friend, Ann, and Ann's young son, Bobby. Ann and Bobby lived with Sally all of 2008 and meet all the tests to be Sally's Qualifying Relative dependents. Ann worked part-time and made \$3,100 in wages during 2008. Ann files a return only to have her withholding refunded. She does not claim her own exemption. Sally can claim Ann and Bobby as dependents.

#### example

All the facts are the same as in the previous example, except, when Ann files her tax return, she also claims the earned income credit. Because Ann did not file her return only to get a refund of her withholding, Bobby must be considered Ann's Qualifying Child. Therefore, Sally cannot claim Bobby as a dependent. Ann cannot claim Bobby as a dependent either, since Ann is a dependent herself. She can use Bobby as a qualifying child for the Earned Income Credit (Earned Income Credit is covered in the Earned Income Credit lesson).

### ***U.S. Citizen or Resident***

Step 4 will guide you to determine citizenship or residency. Also look at the taxpayer's approved intake and interview sheet to see if they have checked the box for dependent information asking if they are a U.S. citizen or a resident of the U.S., Canada, or Mexico. A dependent must be a citizen or resident of the United States, or a resident of Canada or Mexico.

This is a general rule for dependents. It applies to both Qualifying Child and Qualifying Relative.

### ***Gross Income***

Step 5 of the Interview Tips addresses the gross income test. The dependent's gross income for the tax year must be less than the personal exemption amount (\$3,500 for 2008). Gross income is defined in Publication 17, Personal Exemptions and Dependents. Remember this test does not apply to Qualifying Children, only Qualifying Relatives.

#### example

Joe is 65 years old and lives with his son and daughter-in-law. In 2008, Joe's taxable pension income was \$4,700. Joe's son and daughter-in-law cannot claim a dependency exemption for Joe because Joe's income exceeds the exemption amount for 2008, which is \$3,500.

## Support

Step 6 of the Interview Tips asks about support. The taxpayer must have provided more than 50% of the dependent's total support for the tax year. Note that this support test is different than the one for a Qualifying Child.

When calculating the amount of total support, taxpayers should compare their contributions with the entire amount of support their dependent received from all sources (such as taxable income, tax-exempt income, and loans). Review the list of valid support expenses and the worksheet in the Personal Exemptions and Dependents chapter, Publication 17.



Publication 17 contains a worksheet for determining support.

### example

Sherrie's father received \$2,700 from social security and investments, but he put \$300 of it in a savings account and spent only \$2,400 for his own support. Sherrie spent \$2,600 of her income for his support, so she has provided over half of his support.

### example

Steve provided \$4,000 toward his mother's support during the year. His mother had earned income of \$600, nontaxable social security benefit payments of \$4,800, and tax-exempt interest of \$200. She used all of these for her support. Steve cannot claim a dependency exemption for his mother because the \$4,000 he provided was not more than half of her total support of \$9,600.

Social Security benefits received by a child and used towards support are considered to have been provided by the child.

If the taxpayer provides over half the person's total support, you can skip steps 7 through 10 and go directly to step 11. If the taxpayer has not provided over half the person's support, go to step 7 to see if someone else is providing over half the support.

### Multiple Support Agreements

If one person has not provided over half the support, go to step 8 to determine if multiple support exists. Multiple support means that two or more people together, who could claim the person as a dependent except for the support test, provide more than half the dependent's support. However, *only one taxpayer* can claim the exemption for a dependent with multiple support. In this situation, the individuals who provide more than 10% of the person's total support (step 9), and who meet the other tests for a Qualifying Relative, can agree that one of them will take the person's exemption. Step 10 guides you in asking if the taxpayer has the appropriate documentation.

- The taxpayer who is claiming the exemption for the dependent must attach to their tax return Form 2120, Multiple Support Declaration or similar statement.



State benefit payments like welfare, Temporary Assistance for Needy Families (TANF), food stamps, Medicaid, or housing assistance are considered support provided by the state, not by the taxpayer.

Refer to the Worksheet for Determining Support in the Volunteer Resource Guide or the Personal Exemptions and Dependents chapter of Publication 17.

- The other supporting taxpayers must sign this written statement agreeing *not* to claim the exemption for that year. The person who claims the exemption must keep this written statement as a record.

**TIP**

Multiple Support Agreements apply only to a Qualifying Relative, not to a Qualifying Child.

**example**

Fred's father, Charlie, lives with him and receives 27% of his support from social security, 40% from Fred, 24% from Charlie's brother, and 9% from Charlie's friend. Either Fred or Charlie's brother can take the exemption for Charlie because they each provided more than 10% of Charlie's support, and together contributed more than 50% towards his support. Whoever is not going to take the exemption must sign a statement agreeing not to take the exemption.

**example**

Diane and her brother each provided 20% of their grandmother's support for the year. Two persons who are not related to Diane's grandmother, and who do not live with her, provided the remaining 60% of her support equally. No one is entitled to the dependency exemption, since more than half of the grandmother's support is provided by people who can't claim her exemption.

**TIP**

The taxpayers who provide Multiple Support for a dependent decide among themselves who will take the exemption for the year. Volunteer tax preparers do not decide.

### **Joint Return**

To pass the joint return test (steps 11 and 12), the dependent must *not* file a joint return for the year, unless:

- The joint return is filed only to claim a refund, and
- No tax liability would exist for either spouse on separate returns

This is a general rule for dependents. It applies to both a Qualifying Child and Qualifying Relative.

### **Dependent Taxpayer**

The final interview question for a Qualifying Relative is step 13. Look at the question on the taxpayer's approved intake and interview sheet that asks "Can your parents or someone else claim you or your spouse as a dependent on their tax return?" To claim a dependency exemption, a taxpayer cannot be a dependent on another person's tax return. If a taxpayer can be claimed as a dependent by another person, the taxpayer may not claim anyone else as a dependent, even if the taxpayer has a Qualifying Child or Qualifying Relative.

### ***Special Rule for Children of Divorced, Separated, or Never Married Parents***

Special rules apply if the dependent is supported by parents who are divorced or separated; these rules also apply to parents who were never married. After first starting with Table 1, use Table 3: Children of Divorced or Separated Parents within Tab C in your Volunteer Resource Guide to determine which parent is entitled to claim the child as a dependent.

In general, the child will be considered a dependent of the custodial parent, assuming they meet all the rules for a Qualifying Child or Qualifying Relative. However, the custodial parent can agree to allow the noncustodial parent to treat the child as a Qualifying Child or Qualifying Relative if certain conditions are met. A signed Form 8332 or equivalent is required and must be attached to the noncustodial parent's return, or attached to Form 8453 if filing electronically. The Special Rule for Children of Divorced or Separated Parents is described in detail in the Personal Exemptions and Dependents chapter of Publication 17.



This rule does not apply for Head of Household filing status, the credit for child and dependent care expenses, or the earned income credit. For these credits, the child must live with the taxpayer for more than 6 months of the year. The custodial parent may still qualify for those provisions even though the noncustodial parent can claim the dependency exemption.

## **How do I enter the exemptions?**

### **What goes in the TaxWise Dependents/Nondependents section?**

TaxWise determines the taxpayer's dependency exemptions based on the Dependents/Nondependents information entered on the TaxWise Main Information Sheet.

Be sure to include and verify all the family and dependent information on the taxpayer's approved intake and interview sheet before entering the following data into the Dependents/Nondependents section of TaxWise. Let's review the required fields within Tab 1 in the Volunteer Resource Guide.

- Individuals' first and last names
- Individuals' birth dates (MM/DD/YYYY)
- Individuals' social security numbers (SSNs or ITINs) – be sure to physically verify with the actual documentation, such as a social security card
- Relationship to the taxpayer – use the drop-down list to select acceptable entries
- Number of months each individual lived in the taxpayer's home or use MX if the dependent lived in Mexico or CN if the dependent lived in Canada – type in directly or use the drop-down list
- Codes for dependents and nondependents – select the correct dependent code from the drop-down list or type that number in this field
  - 1 - your dependent child who lives with you
  - 2 - your dependent child who does *not* live with you due to divorce or separation
  - 3 - all other dependents

0 (zero) - nondependent

List nondependents only if they are Qualifying Children for the Earned Income Credit or Dependent Care Credit

Child Tax Credit or Dependent Care Credit

- Check the box(es) if the Dependent Care Credit and/or Earned Income Credit apply to the individual



**TaxWise Hints:** TaxWise offers context-sensitive help for the current field.

List the dependents from the youngest to the oldest to ensure that the Earned Income Credit is calculated correctly.

For more than four dependents, enter first four on Main Information Sheet. Link to Additional Dependent Statement from Page 1 of 1040.

Carefully read the information regarding Dependents/Nondependents, and pay special attention to the codes.

Be sure to check the DC box if the child qualifies for the child and dependent care credit and check EIC if they may qualify for earned income credit.

CTC (Child Tax Credit) eligibility is automatically determined by TaxWise for each child entered.

Be sure to verify names, SSN/ITIN and dates of birth to prevent rejected returns.

For noncustodial parents or Multiple Support agreements, be sure to check the appropriate box regarding the necessary documentation.



The dependent codes correspond to the applicable boxes on Form 1040 and 1040A. Box 6c1 - number of children who lived with you; box 6c2 - number of children who did not live with you due to divorce or separation; 6c3 - number of dependents not listed above.



If a child was born and died during the year they can still be claimed as a dependent. An SSN is not required but the return cannot be e-filed in that case. The tax return must be mailed in. Refer to the Filing Information chapter of Publication 17.

## Taxpayer Example

Elaine Smith has one Form W-2 from her clerk job of 36 years. She has been divorced from her husband for over 20 years. She is the main provider for her two grandchildren and two of her grown sons, who live with her. Her sons worked odd jobs and earned about \$4,000 each. They are not disabled. The grandchildren are not the children of the sons that live with her. She would like to file a tax return and claim her sons and grandchildren as dependents.

c. IS your spouse deceased? If yes, provide the date of death. \_\_\_\_\_

## Part II. Family and Dependent Information – Do not include you or your spouse.

Print the name of everyone who lived in your home and outside your home that you supported during the year.

Name (first, last)	Date of Birth mm/dd/yyyy	Relationship to you (son, daughter, etc.)	Number of months person lived with you last year	US Citizen, Resident of US, Canada or Mexico (yes or no)	Is the dependent a full time student? (yes or no)
(a)	(b)	(c)	(d)	(e)	(f)
Lisa Smith	12/01/2004	Granddaughter	12	yes	no
Brian Smith	12/01/2004	Grandson	12	yes	no
Michael Smith	03/17/1982	Son	12	yes	no
Todd Smith	09/05/1980	Son	12	yes	no

### ***How do I apply the dependency tests to Elaine's sons?***

Use the Interview Tips in the Volunteer Resource Guide to apply the test to each of Elaine's sons.

### ***How do I apply the dependency tests to Elaine's grandchildren?***

Use the Interview Tips in the Volunteer Resource Guide to apply the test to each of Elaine's grandchildren.

### ***Dependents/Nondependents section of TaxWise***

Elaine can claim her two grandchildren as dependency exemptions, but not her live-in sons. Therefore, you use the Family and Dependent Information section of Elaine's approved intake and interview sheet to enter the information for her two children. TaxWise will use this information to calculate Elaine's exemption deduction.

## **Practice– Vanessa Franklin**



Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-9 and review the sample interview with Vanessa related to dependency exemptions.

## **Summary**

### **Qualifying Child and Qualifying Relative Dependent Tests**

For a taxpayer to claim a dependency exemption, the dependent must be a U.S. citizen or resident, or a resident of Canada or Mexico, and the dependent cannot file a joint return unless neither spouse will have a tax liability and the joint return is filed only to claim a refund. Persons claiming the dependent cannot themselves be claimed as a dependent on another person's return. In addition, the dependent must be either a Qualifying Child or a Qualifying Relative; each has slightly different requirements. If the dependent does not meet the tests for Qualifying Child, he or she may still be eligible under the rules for Qualifying Relative. Use the Interview Tips to apply the tests for dependents.

## Completing the Exemptions Section

After verifying that the dependents are qualified, enter the taxpayer's dependents' information in the Dependents/Nondependents section of the TaxWise Main Information Sheet. TaxWise will use this information to calculate the taxpayer's exemption deduction.

## Filing Status and Exemptions Practice

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The Filing Status and Exemptions sections of the tax return may take only a few minutes to complete, but they encompass some of the most complex tax law issues. Determining the correct filing status and whether a taxpayer has a "Qualifying Child" or a "Qualifying Relative" can impact many other areas of the return.

This section gives you practice applying what you have learned so far. You will review the taxpayer's approved intake and interview sheet, as well as the interview between the taxpayer and a volunteer. You will complete the Exemptions section of Form 1040 and check your work. You will also find questions throughout this lesson. Try answering each one, and then compare your responses with the correct answers at the end of the lesson.

Use the Interview Tips in the Volunteer Resource Guide for probing questions, and refer to Publication 17 if you need more information.

## Did the taxpayer complete the approved intake and interview sheet?

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Janet Smith needs assistance completing her tax return. She completes the approved intake and interview sheet to the best of her ability. Carefully review Parts I and II.



**Part I: Taxpayer Information**

1. Your First Name Janet		M.I.	Last Name Smith		2. Date of Birth (mm/dd/yyyy) 03/28/1965
3. US Citizen or Resident Alien <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	4. Legally Blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		5. Totally and Permanently Disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		6. Occupation
7. Spouse's First Name Herman		M.I.	Last Name Smith		8. Date of Birth (mm/dd/yyyy) 03/16/1962
9. US Citizen or Resident Alien <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	10. Legally Blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		11. Totally and Permanently Disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		12. Occupation
13. Address 1234 Main Street			Apt #	City Boise	State ID Zip Code 83702
14. Phone Number and e-mail address Phone: (208 ) 333-3333 e-mail:			15. Could you or your spouse be claimed as a dependent on the income tax return of any other person? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
16. On December 31 <sup>st</sup> a. Were you: <input type="checkbox"/> Single <input checked="" type="checkbox"/> Legally Married <input type="checkbox"/> Separated <input type="checkbox"/> Divorced <input type="checkbox"/> Widowed b. If married, did you live with your spouse during any part of the last six months of the year? <input type="checkbox"/> Yes <input type="checkbox"/> No c. Is your spouse deceased? If yes, provide the date of death. (mm/dd/yyyy)					

**Part II. Family and Dependent Information – Do not include you or your spouse.**

Print the name of everyone who lived in your home and outside your home that you supported during the year.

Name (first, last)	Date of Birth mm/dd/yyyy	Relationship to you (son, daughter, etc.)	Number of months person lived with you last year	US Citizen, Resident of US, Canada or Mexico (yes or no)	Is the dependent a full time student? (yes or no)
(a)	(b)	(c)	(d)	(e)	(f)
Rodney Smith	03/22/1995	son	12	yes	yes
Loretta Smith	11/13/1985	daughter	8	yes	yes

**EXERCISES**

The answers appear at the end of this lesson.

**Question 1:** Is the information complete? ☐ Yes ☐ No

**Is the filing status information complete?**

The volunteer notices that Janet did not provide complete information about her marital status. Without that information, Janet's filing status is unclear. At this point, the volunteer gets more information by using the Interview Tips for filing status and personal exemptions:



## SAMPLE INTERVIEW

VOLUNTEER SAYS...

JANET RESPONDS...

*I see that you left blank the question “Were you living apart from your spouse during the last six months of the year?” Were you unsure of what to put there?*

Yes, it’s kind of complicated.

*Tell me what you can.*

My husband moved out last April, but he moved back in with me right before Christmas. But that just didn’t work out, so he left again in January. I wasn’t sure if that meant we were living together or not.

*I see. The important thing here is to determine which filing status is right for you, so let’s go over it step by step. Were you still married on December 31st, 2008?*

Yes, we intended to go to court to get a legal separation, but we never got around to it.

*I understand. Since you and your husband lived together for a little while during the last half of the year, you can’t file as Head of Household. Since you’re still legally married, you can file either Married Filing Jointly, or Married Filing Separately. Are you and your husband filing a joint tax return?*

No, definitely not!

*Then we’ll go with Married Filing Separately. It does make a difference to some credits, but the good thing is that you’re only responsible for your own income tax.*

### Is the personal exemption information complete?



#### EXERCISES (continued)

**Question 2:** Based on the Interview Tips and on the information the taxpayer provided, do you have enough information to decide if she can claim a personal exemption for herself and for her husband? ☐ Yes ☐ No

**Question 3:** If you answered “no,” what additional information would you need?

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

JANET RESPONDS...

*Did your spouse have income or can anyone else claim your spouse as a dependent?*

Yes, he did receive a little unemployment compensation, but he’s not anyone’s dependent – he’s in his 40’s and should be supporting his family!

## Is the dependency exemption interview complete?

The volunteer asks Janet about each child's information. The volunteer turns to the Interview Tips for dependency exemptions in the Exemption section of the Volunteer Resource Guide (Tab C). Here are the questions the volunteer asks Janet about Loretta:

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Tell me about your daughter's situation.*

*Did she provide over half of her own support?*

*Let me ask you a few more questions to figure that out.*

*We know that she is your daughter. Is she a U.S. citizen?*

*Is she married and filing a joint return for this year?*

*I see you responded that she is a full-time student.*

*She was also under the age of 24 at the end of 2008.*

*Correct?*

*Okay, that brings us to whether your daughter provided over half of her own support. Do you have any records that show how much you spent to provide for her and how much she paid herself?*

#### JANET RESPONDS...

Well, she lived at home with me for eight months and worked at a full-time job while going to city college part time. Then in August she left for state college where she got a part-time job and took classes full-time.

I wasn't sure if she or I provided half her support over the year or not.

Yes, of course.

No.

Yes, she's 22 and has been in school since August. She lived with me before leaving for State.

Well, I don't have records with me, but I know how much we spend each month. And I know that my daughter made around \$8,000 this year.



### EXERCISES (continued)

**Question 4:** Did this interview give you enough information to decide if the taxpayer can claim an exemption for her daughter? ☐ Yes ☐ No

**Question 5:** If your answer is "no," what additional information would you need?

The volunteer realizes the Interview Tips for the Dependency Exemption cannot be completed without determining the level of support. The taxpayer must determine what part of the following expenses she provided for her daughter – food, clothing, housing costs (fair rental value), medical/dental, education, transportation, automobile, and other living expenses. She then compares that with what her daughter provided for her own support.

The volunteer helps Janet complete the Worksheet for Determining Support from Publication 17. Together they determine that the daughter provided more than 50% of her own support for 2008.



### EXERCISES (continued)

**Question 6:** Can Janet claim a dependency exemption for her daughter?

☐ Yes ☐ No

The volunteer can now complete the approved intake and interview sheet. The volunteer already determined that the taxpayer will file Married Filing Separately, so the box for MFS should be checked. The volunteer should also note that Loretta provided more than 50% of her own support, so the quality reviewer will know why Loretta is not being claimed as a dependent. On the appropriate line, the volunteer will write “1” since only the son, Rodney, qualifies as a dependent.

## How do I complete the exemptions section of the return?

By now, you should have reviewed and confirmed the filing status and dependency determinations from the taxpayer’s approved intake and interview sheet and the interview questions.

To transfer the information to the TaxWise Main Information screen, Exemptions section, complete lines 6a through 6c of the Exemptions section and the Dependents/Nondependents section.

The “Code” entry gives the software information about the relationship between the dependent and the taxpayer. Choose carefully, as this code will impact how the software treats the dependent for some credits. The checkboxes for Dependent Care (DC), Earned Income Credit (EIC), and Child Tax Credit will also impact tax credits that you will learn about in later lessons. TaxWise will carry this information to page 1 of Form 1040, completing lines 6a through 6d.

On a paper return, you complete lines 6a through 6d by hand. When listing dependents on line 6c, you will check the box in column (4) to indicate if the dependent is eligible for the Child Tax Credit.

The Filing Status and Exemptions section of your Form 1040 should look like this:

**Filing Status**  
Check only one box.

1 ☐ Single  
2 ☐ Married filing jointly (even if only one had income)  
3 ☒ Married filing separately. Enter spouse's SSN above and full name here. ▶ **Herman Smith**  
4 ☐ Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶  
5 ☐ Qualifying widow(er) with dependent child (see page 14)

**Exemptions**  
If more than four dependents, see page 15.

6a ☐ Yourself. If someone can claim you as a dependent, do not check box 6a  
b ☐ Spouse

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 15)
Rodney	Smith	000 00 0000	son	<input checked="" type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>

d Total number of exemptions claimed

Boxes checked on 6a and 6b: 1  
No. of children on 6c who:  
• lived with you: 1  
• did not live with you due to divorce or separation (see page 16):  
Dependents on 6c not entered above:  
Add numbers on lines above: 2



## EXERCISE ANSWERS

**Answer 1:** No, the taxpayer left blank a question about living with her husband during the last six months.

**Answer 2:** No, the volunteer doesn't have enough information to discover if Janet can claim a personal exemption for her husband. Although the volunteer covered some of the questions presented in the Interview Tips, the volunteer needs to ask the rest of the questions.

**Answer 3:** The volunteer needs to determine if the spouse had any income, or if anyone else can claim the spouse as a dependent.

**Answer 4:** No, the interview was incomplete.

**Answer 5:** The volunteer needs to go back and ask questions about the level of support to make the correct decision. Did the daughter provide more than 50% of her own support? The taxpayer must determine what percent of the total amounts she spent on the following expenses for her daughter's share of: food, clothing, housing costs (fair rental value), medical/dental, education, transportation, automobile, and other living expenses, and compare that with what her daughter provided for her own support.

**Answer 6:** No, Janet's daughter provided more than 50% of her own support.

### Introduction

This lesson will assist you in addressing some filing status issues you may encounter when helping service members whose spouses are nonresident aliens (not U.S. citizens or permanent resident aliens).

This lesson also covers exemption issues related to taxpayers who want to claim an exemption for:

- A nonresident alien spouse who does not qualify to be a resident alien for tax purposes, and/or
- Nonresident alien stepchildren

Tax situations involving nonresident aliens can be complex. If the taxpayer has a J, Q, F, or M visa, ask the site coordinator if there is a volunteer who is trained and certified to prepare these types of returns.

If there isn't a certified volunteer at the site or if you are faced with a situation not covered in this lesson, refer the taxpayer to a professional tax preparer.

### Objective

At the end of this lesson, using your resource materials, you will be able to:

- Determine the unique filing status issues you may encounter when helping service members whose spouses are nonresident aliens (not U.S. citizens or permanent resident aliens)

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 519

#### Optional:

- ☐ Publication 3
- ☐ Publication 54
- ☐ Form 1040NR-EZ
- ☐ Form 1040NR

### How do I apply tax law to nonresident aliens?

Nonresident aliens can be students, teachers, trainees, and/or undocumented immigrants. Your role is to determine if nonresident aliens can be treated as resident aliens for tax purposes. If they can, most tax rules (with certain exceptions) that apply to U.S. citizens apply to nonresident aliens, including filing status and exemption issues. Resident aliens and U.S. citizens must report worldwide income on their tax return.

Keep in mind that a person is considered married no matter where in the world they were married. It does not matter if one spouse is living in another country. The person who is the resident alien/citizen still must follow tax rules for married persons.

Filing a tax return as a resident alien does not affect the person's immigration status in any way.

### Who is a citizen, resident alien, or nonresident alien?

Let's begin by looking at the approved intake and interview sheet. Locate the part of the form where taxpayers and/or their spouses indicate whether or not they are U.S.

citizens or resident aliens. In another part of the form, taxpayers indicate citizenship or residency of family members and dependents.

If the taxpayer has checked “no” for U.S. citizen or resident alien on the approved intake and interview sheet, you must determine if the person can be treated as a resident alien for tax purposes before continuing. An individual must meet one of the following tests to be considered a *resident alien for tax purposes*:

- Green Card test
- Substantial Presence test

### **What is the Green Card test?**

Individuals who were lawful permanent residents of the U.S. at any time during the tax year are resident aliens. These people were given the privilege, according to immigration laws, of residing permanently in the U.S. They receive alien registration cards, commonly known as a “green cards,” attesting to this status. Green cards are approximately the size of driver licenses. They are no longer green in color, but still hold the name. Most green card holders have valid social security numbers and must follow the same tax laws as U.S. citizens, including the requirement to report worldwide income on their tax returns.

More information about green card holders is available in Publication 4588, Basic Tax Guide for Green Card Holders, found at [www.irs.gov](http://www.irs.gov).

### **What is the Substantial Presence test?**

This test is based on a formula of days and years a person is physically present in the United States. If individuals do not have green cards, find out if they meet the Substantial Presence test, which allows them to be treated as resident aliens for tax purposes.

Page 9 of the Volunteer Resource Guide reprints the decision tree, Nonresident Alien or Resident Alien? from Publication 519, U.S. Tax Guide for Aliens. It is used to determine if an alien is a resident alien or nonresident alien for tax purposes.

Use the Resident Alien or Nonresident Alien? decision tree to determine an individual's residency status.

#### **example**

PFC Gloria Benton's husband, Dante, does not have a green card nor a visa. Dante does not have a tax home in another country. He was physically present in the U.S. for 150 days in each of the years 2006, 2007, and 2008. Is Dante a resident alien under the Substantial Presence test for 2008?

The decision tree indicates that Dante does meet the Substantial Presence test and is considered a resident alien for tax purposes.

2008: 150 days. 2007:  $\frac{1}{3}$  of 150=50 days  
2006:  $\frac{1}{6}$  of 150 days=25 days.

Total days=225 days.

### **Who is exempt from the Substantial Presence test?**

People who are in the U.S. on valid F, J, M or Q visas are usually considered exempt from the Substantial Presence test.

For individuals with valid visas, do not count the days present in the U.S. for purposes of the Substantial Presence test. In general, these people will be considered *nonresident aliens for tax purposes*. Other examples of exempt individuals include:

- Nonresident aliens with medical conditions that prevent them from leaving the country, and
- Certain commuters between the U.S., Canada and Mexico



Most VITA sites do not prepare returns for individuals with F, J, M, or Q valid visas. Ask the site coordinator if there is a volunteer who is certified to prepare these types of returns. If not, refer the taxpayer to a professional tax preparer.

Publication 519 has more detailed information on who is an exempt individual.



If a person's visa has expired or the person is not complying with the requirements of the visa, then that person is not an exempt individual and cannot exclude those days they are physically present in the U.S.

### ***What if a nonresident alien meets the Substantial Presence test?***

Nonresident aliens who meet the Substantial Presence test are treated as resident aliens for tax purposes.

No paperwork or documentation is needed to indicate that a person is a nonresident alien filing as a resident alien under the Substantial Presence test.

All persons listed on the return must have either a valid social security number or an ITIN. ITINs are discussed in the Filing Basics lesson.

If the taxpayer will be applying for an ITIN, you may prepare the return. Follow the instructions in the Volunteer Resource Guide under Tab 1, Starting TaxWise. Select the "Apply for ITIN" option and TaxWise will generate a unique identifier that will always begin with ITIN and will be followed by 5 numeric characters. This section will also instruct you on how to advise the taxpayer to file the return and application. Remind taxpayers that they must send in the return with Form W-7, Application for IRS Individual Taxpayer Identification Number or Form W-7SP (Spanish version).

IRS Taxpayer Assistance Centers or acceptance agents can help the taxpayer complete Form W-7 or Form W-7SP. Most acceptance agents, other than the IRS, charge a fee for this service.

For more information about acceptance agents, see Publication 4393, What is an IRS ITIN Acceptance Agent. You can find this publication and more information about acceptance agents on [www.irs.gov](http://www.irs.gov), keyword "acceptance agent."

Use the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide (page 9) to determine if a person meets the Substantial Presence test.



An individual with an ITIN is not entitled to the Earned Income Credit. This will be covered in the Earned Income Credit lesson.



A return with an ITIN can be e-filed. A return missing an ITIN *cannot* be e-filed.



#### example

Sgt. Paul Kingman and his wife, Gabriella, were married at the end of 2008. Gabriella does not have a green card nor a valid visa. They have no children and are not supporting anyone else.

Gabriella lived in the U.S. for 120 days in 2008 (from September to December) as a nonresident alien. She was also in the U.S. for 120 days in each of the years 2006 and 2007. Gabriella does not have a tax home in another country. Does Gabriella meet the Substantial Presence test?

Following the decision tree, you find that Gabriella does not meet the Substantial Presence test. For tax purposes, she is considered a nonresident alien.

2008: 120 days: 2007:  $\frac{1}{3}$  of 120 days=40 days    2006:  $\frac{1}{6}$  of 120 days=20 days

The total days she can take into consideration are 183.

### **What if an unmarried nonresident alien does not meet the Green Card or Substantial Presence test?**

Refer unmarried individuals who do not meet either the Green Card or Substantial Presence test to a volunteer who has been trained and certified to prepare returns for nonresident aliens or a professional tax preparer to file Form 1040NR or Form 1040 NR-EZ.

### **Can we assist a married couple when a spouse does not qualify to be treated as a resident alien using the Green Card or Substantial Presence test?**

Yes! Married couples in this situation have a few options when it comes to filling a tax return. In the example above, Gabriella (wife of Sgt. Paul Kingman) does not meet the Green Card nor Substantial Presence test. Thus, she is considered a nonresident alien.

However, as a citizen married to a nonresident alien spouse who does not meet either the Green Card or Substantial Presence test, Sgt. Kingman has four filing status options:

1. He may choose to file as Married Filing Separately
2. The couple may chose to file as Married Filing Jointly
3. He may qualify for Head of Household under the regular rules for a married person who is *considered unmarried* for Head of Household purposes
4. He may qualify to file as Head of Household, even *while living with the nonresident alien spouse*

### **Who can file a joint return?**

Even though Gabriella does not pass the Green Card test or the Substantial Presence test, it is possible for this married couple to file a joint return. The couple may elect to treat the nonresident alien spouse as a resident alien for tax purposes. This information can be found in Publication 519, U.S. Tax Guide for Aliens.



### ***How does a couple elect to treat the nonresident alien spouse as a U.S. resident for tax purposes?***

If the nonresident alien spouse agrees to file a joint return, worldwide income must be reported, and a signed declaration is attached to the back of the return stating:

- Both people qualify to make the choice to be treated as U.S. residents for the entire year
- The name, address, and SSN or ITIN of each spouse

### ***How does this election affect filing status in future years?***

The election continues in future years but the spouses can file separately after the first year, if they choose. The election to treat the spouse as a resident is terminated by revocation, the death of either spouse, their legal separation, or the IRS may terminate it for failure to keep adequate records.

#### **TIP**

Make a note by step 2 of the Volunteer Resource Guide that, if a spouse is a nonresident alien, the taxpayer can still make the choice declaration.

#### **example**

Even though Gabriella, Sgt. Paul Kingman's nonresident alien wife, does not pass the Green Card or Substantial Presence test, they both agree to choose to treat Gabriella as a resident alien by attaching a signed statement to their joint return. Paul and Gabriella must report their worldwide income for the year and for all later years unless the choice is ended or suspended. Although Paul and Gabriella must file a joint return for the year they make the choice, they may file either joint or separate returns for later years.

## **Who can file Head of Household?**

As you learned in a previous lesson, married taxpayers can be *considered unmarried* and claim Head of Household status if they have not lived with their spouse for the last six months of the year, and if they meet a few other requirements.

Follow the filing status Interview Tips in the Volunteer Resource Guide (Tab B) to see if the citizen spouse qualifies to file as Head of Household.

### **Can citizens or resident aliens who live with their nonresident alien spouse ever file as Head of Household?**

Yes. There is an exception that allows U.S. citizen and resident alien spouses who live with nonresident aliens to file as Head of Household. All of the following requirements must be met:

- The taxpayer is a U.S. citizen or resident alien for the entire year and meets all the "considered unmarried" rules for Head of Household except for living with the nonresident alien spouse
- The nonresident alien spouse does not meet the Substantial Presence test
- The nonresident alien spouse does not choose to file a joint return



## EXERCISES

**Question 1:** Gloria's husband, Dante, meets the Substantial Presence test. Gloria is a U.S. citizen. They do not have any children and do not support anyone else. Dante is applying for an ITIN. Gloria has an SSN. They live together. Dante meets the Substantial Presence test and is treated as a resident alien for tax purposes. Refer to Tab B, filing status, in the Volunteer Resource Guide.

What filing status options does Gloria have for 2008?

**Question 2:** Sgt. Raul Thomas is a U.S. citizen and serving in the U.S. Army in Japan. His wife and his children live with him and he is able to claim the children as dependents. Raul's wife, a citizen of Japan, chooses not to be treated as a resident alien for tax purposes. She does not want to file a joint return with him.

Raul meets all of the other qualifications for Head of Household. Even though he is married and living with his spouse, can he claim Head of Household status?

☐ Yes ☐ No

### **Can a taxpayer filing Head of Household who is married to and living with a nonresident alien spouse claim the Earned Income Tax Credit, if they are otherwise eligible?**

No. Taxpayers who are considered unmarried for Head of Household purposes (because they are married to a nonresident alien) are still considered married for purposes of the Earned Income Credit. Taxpayers are only entitled to the credit if they file a joint return and meet the EIC qualifications.

#### **TIP**

In the Volunteer Resource Guide, turn to Tab B, Filing Status. Notate the fact that, if a spouse is a nonresident alien, the *living apart* rule does not apply to the citizen spouse. You will also find this information in Publication 17, under *Head of Household, nonresident alien*.



In this situation, the 2008 1040 Instructions say to enter "NRA" on line 4 (Head of Household status) of Form 1040. When preparing a paper return for such a nonresident alien taxpayer, also write "no" on the dotted line next to line 64a (Earned Income Credit) of Form 1040.

## **Personal Exemptions**

### **Can the citizen/resident alien spouse claim the personal exemption of the nonresident alien spouse when the nonresident alien spouse does not meet the Substantial Presence test and does not choose to file a joint return?**

Yes, if certain tests are met. Turn to the personal exemptions decision tree in the Volunteer Resource Guide under Tab C. Use the Interview Tips to see if the citizen spouse can claim the personal exemption of the nonresident alien spouse. It does not matter if the citizen spouse is filing as Married Filing Separately or as Head of

Household. Make a note on step 6 that, for a nonresident alien spouse, income is defined as U.S.-sourced income only. All the other rules apply as stated. To clarify Step 6, the person cannot be claimed as a dependent of another on a U.S. tax return.

#### example

Raul (mentioned earlier) is a U.S. citizen serving in the U.S. Army in Japan. His wife and children live with him and he is able to claim the children as dependents. Raul's wife, a citizen of Japan, chooses not to file a joint return with him. Raul can claim his wife's personal exemption as long as she has no U.S. source income, she is not anyone else's dependent, and has an ITIN or SSN.

#### example

Major Tom Beckley is a U.S. citizen. He married Anna, a Korean citizen, in 2008, but came back to the U.S without her. Anna is still in Korea getting her paperwork in order. She did not choose to file a joint return with him. Major Beckley is filing as Married Filing Separately. Anna has no U.S.-sourced income and cannot be claimed as a dependent on anyone else's U.S. tax return. She has an ITIN for now. Major Beckley can claim her personal exemption on his tax return.



When preparing a paper return for a taxpayer who is filing as Married Filing Separately, claim the exemption by checking box 6b (spouse's exemption) of Form 1040. Enter the name of the spouse in the space to the right of the box. Enter the ITIN or SSN of the spouse in the space provided at the top of Form 1040. This is where the spouse's SSN or ITIN would be entered if a joint return was being filed.

## How do I enter the filing status into TaxWise?

Turn to Tab 1, Starting TaxWise in the Volunteer Resource Guide. Find the Main Information Sheet screen shots. Notate on the appropriate pages how to claim the nonresident alien spouse's personal exemption for each of these situations.

Find the page with the filing status section. If the taxpayer is filing as Married Filing Separately, go to the line that says Married Filing Separately and fill in the spouse's name and SSN or ITIN. Now find the Main Information Sheet screen shot that shows the dependents/nondependent section. List the spouse's name, date of birth and SSN or ITIN and write "other" in the relationship column. Enter the number of months, if any, the spouse lived in the home. Enter "3" in the code column. A "3" means all other dependents.

If the taxpayer is filing as Head of Household and claiming the nonresident alien spouse's personal exemption, go to that line in the filing status section of the Main Information Sheet. Check the Head of Household box. On the Main Information Sheet, under "exemptions," check the box under 6(c) that states that you are using filing status 4 and claiming an exemption for a nonresident alien spouse. Enter the person's name and TIN in the space provided. Do not enter the person again in the dependent/nondependent section of the Main Information Sheet.

## Dependency Exemptions

### Can a taxpayer claim a dependency exemption for a child born overseas, a foreign-born stepchild, and/or an adopted foreign-born child?

#### ***Child born overseas to a U.S. citizen***

Children born overseas to U.S. citizen parents are considered to be U.S. citizens for tax purposes. A child can be claimed as a dependent as long as all the other rules for qualifying child or qualifying relative are met.

The birth of a child abroad should be reported as soon as possible for the purpose of establishing an official record of the child's claim to U.S. citizenship at birth. Form FS-240, Consular Report of Birth, establishes official evidence that the child is a U.S. citizen.

#### **example**

Sgt. Patricia Spencer, a U.S. citizen, is married to Gilberto, a nonresident alien from Spain. Their daughter, Eva, was born in Spain, where they live.

Eva is entitled to U.S. citizenship. Her mother should check with the military office for information on reporting the birth of the child so Eva will be recognized as a U.S. citizen. Eva will need a social security number to be claimed as a dependent on her mother's tax return.



While applying for the Consular Report of Birth, parents should also apply for a social security number and passport for their child. Without a social security number, the parents will not be able to claim the child as a dependent nor take advantage of credits, such as the Earned Income Tax Credit or the Child Tax Credit, even if all of the other prerequisites are met.

### Can a foreign-born stepchild be claimed as a dependent?

If a child is a nonresident alien, before addressing the dependency exemption question, it is necessary to confirm the child's U.S. residency status for tax purposes. Turn to the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide, page 9.

#### **example**

Sgt. Terry Summers, a U.S. citizen, is married to a German citizen whose three children are German citizens and do not have green cards. Sgt. Summers has not adopted the children. They all live in Germany.

Follow the decision tree. The children do not have green cards and were not physically present in the U.S. during the tax year. They are nonresident aliens for tax purposes.

Now turn to the Interview Tips under Dependency Exemption for Qualifying Child. Step 5 asks, *Is the person a U.S. citizen, U.S. national, or a resident of Canada or Mexico?* The answer is "no." The children do not meet the citizenship test. Sgt. Summers cannot claim the children as dependents.

### ***What if Sgt. Summers adopted the stepchildren?***

Continuing the example above, if Sgt. Summers adopted the stepchildren and *they lived with him all year*, even though they are still not citizens of the U.S., Sgt. Summers could answer “yes” to the citizenship test. If all the other rules were met for a qualifying child or qualifying relative, he could claim the adopted nonresident alien children as dependents on his tax return. Of course, the children would have to obtain SSNs, ITINs, or ATINs to be claimed on his tax return.

An Adoption Taxpayer Identification Number (ATIN) can be obtained when a domestic adoption is pending and other rules are met. An ATIN can be obtained in the case of a foreign adoption when the child already possesses a green card or a certificate of citizenship (a form claiming citizenship because a child was born overseas to a U.S. citizen).

See Publication 17 under the Citizen or Resident test in Chapter 3 for more information, including who is considered a U.S. national.



An adopted nonresident alien child must live with the taxpayer all year to pass the citizen or resident alien test.



### **EXERCISES** (continued)

**Question 3:** Sgt. Summers moves his family to the U.S. in January. The stepchildren are still not U.S. citizens and they do not have green cards. Can he claim the stepchildren as dependents on his tax return? ☐ Yes ☐ No

Since they are nonresident aliens, you must first determine their residency status. Do the children meet the Substantial Presence test? If they do, how would Sgt. Summers answer step 5 of the Dependency Exemption for Qualifying Child Interview Tips? ☐ Yes ☐ No

**Question 4:** Sgt. John Ramsey, a U.S. citizen who has been in the U.S. Army for 13 years, is stationed in Germany. His wife is a German citizen who has never lived in the U.S. Their two-year-old son was born in Germany. Sgt. Ramsey’s 12-year-old stepdaughter, a German citizen whom Sgt. Ramsey has not adopted, also lives with them. The Ramseys provide total support for the two children. How many dependency exemptions can Sgt. Ramsey claim on a joint return?

- A. One
- B. Two
- C. Three
- D. Zero

## Summary

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Before filing a tax return, U.S. citizens married to a spouse who is not a U.S. citizen national or has a Green Card must determine what filing status options are available and whether the noncitizen spouse will be treated as a resident alien for tax purposes or as a nonresident alien.

Resident aliens follow the same tax laws as U.S. citizens. Nonresident aliens follow another set of tax laws, most of which are outside the scope of the VITA program.

To determine the residency status of a noncitizen, use the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide, page 9.

A married couple, where a citizen or resident alien is married to a person who does not meet the Green Card or Substantial Presence test, still has the option of electing to treat the nonresident spouse as a resident alien and file as Married Filing Jointly.

If the nonresident alien spouse does not meet the Green Card or Substantial Presence tests and does not choose to file a joint return, under certain circumstances, the U.S. citizen or resident alien can file as Head of Household even though the couple lives together.

A U.S. citizen or resident alien may claim the nonresident alien spouse's personal exemption as long as the spouse:

- Had no U.S.-sourced income
- Cannot be claimed as a dependent on someone else's U.S. tax return, and
- Has a TIN

A U.S. citizen's child is usually a U.S. citizen by birth, even if the child is born in another country.

A nonresident alien stepchild who does not meet the Green Card or Substantial Presence tests cannot be claimed as a dependent of the U.S. citizen or resident alien because the child does not pass the citizenship test.

An adopted nonresident alien child can usually be claimed as a dependent of a U.S. citizen or resident alien if the child lives with the U.S. citizen the entire year.



**Answer 4:** A. Sgt. Ramsey can claim one dependency exemption for his son on his joint return. The son qualifies as a U.S. citizen because his father is a U.S. citizen. The stepdaughter does not meet the U.S. citizen or resident test. A spouse is never considered a dependent, although Sgt. Ramsey may be able to take her personal exemption.

This image shows a single sheet of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible. The paper has a slight shadow on the right side, suggesting it's resting on a surface.

[illegible]



## Income – Wages, Interest, Etc.






### Form 1040, Lines 7-11

#### Introduction

You have learned how to determine the most beneficial filing status and the allowable personal/dependency exemptions. The rest of this training includes reported income, deductions, and credits. Use the tools and resources provided (including an approved intake and interview sheet and Form 1040) to interview the taxpayer and to calculate the correct tax. The income topics follow the order they appear on Form 1040, lines 7 through 22. Review the Income lesson topics (listed below) that are required for the course in which you want to certify.

There are two topics that are not covered in the VITA/TCE training program: “Other Gains/Losses” and “Farm Income.” If a taxpayer comes to your site with income from sources not included in this training, they should be referred to a professional tax preparer. The return preparation for a dependent child under the age of 18 or 24 who has investment income of more than \$1,800 should also be referred to a professional preparer.

The chart below will help you to select the appropriate topics for your certification course.

Lesson	Form 1040	Topics	Certification Course				
			 Basic	 Intermediate	 Advanced	 Military	 International
8	Line 7	Wages	■	■	■	■	■
8	Line 8	Interest Income	■	■	■	■	■
8	Line 9	Dividend Income	■	■	■	■	■
8	Line 10	Taxable Refunds	N/A	■	■	■	■
8	Line 11	Alimony Received	N/A	■	■	■	■
9	Line 12	Business Income	N/A	■	■	■	■
10	Line 13	Capital Gain/Loss	N/A	N/A	■	■	■
N/A	Line 14	Other Gains/Losses	N/A	N/A	N/A	N/A	N/A
11	Line 15	IRA Distributions	N/A	■ *	■	■	■
11	Line 16	Pensions/Annuities	N/A	■ *	■	■	■
12	Line 17	Rental Income	N/A	N/A	N/A	■	■
N/A	Line 18	Farm Income	N/A	N/A	N/A	N/A	N/A
13	Line 19	Unemployment Compensation	■	■	■	■	■
14	Line 20	Social Security Benefits	N/A	■	■	■	■
15	Line 21	Other Income	■	■	■	■	■
		Foreign Earned Income	N/A	N/A	N/A	N/A	■
16	Line 21	Military Income	N/A	N/A	N/A	■	■
*Pensions/Annuities are Intermediate if the taxable amount is already determined.							



**TaxWise Hint:** When preparing a return with TaxWise, always select Form 1040 on the Main Information Sheet. It provides options to deal with the widest range of possibilities. When the return is ready to print, go back to the Main Information Sheet to see which form (1040EZ, 1040A, or 1040) is recommended.

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Schedule C-EZ

#### **Optional**

- ☐ Form 1040 Instructions
- ☐ Schedule B
- ☐ Publication 531
- ☐ Publication 926
- ☐ Publication 970

## Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- Taxable and nontaxable income for lines 7–21 of Form 1040
- What is earned and unearned income
- How to report income on lines 7–21 of Form 1040 correctly

## How are taxable and nontaxable income determined?

All income (gross income) is presumed to be taxable unless specifically excluded or exempted by the Internal Revenue Code.

### What are types of non-taxable or exempted income?

- Non-taxable income - includes such things as gifts and inheritances. Excludible income is not shown on the return.
- Exempted income - includes such things as interest income produced from certain types of investments. There are some instances when exempted income is shown on the return, but not included in the income tax computation, e.g. tax-exempt interest income.

### What are types of taxable income?

The Income section of Form 1040 is used to report earned and unearned taxable income. The sum of all earned and unearned income is reported on Form 1040, line 22 as total income.

- Earned income – any income received for work, such as wages or business income reported on Form 1040, Schedule C, Profit or Loss From Business, or Form 1040, Schedule C-EZ, Net Profit From Business, or Form 1040, Schedule F, Profit or Loss From Farming
- Unearned income – any income produced by investments, such as interest on savings, dividends on stocks, or rental income

The income chart in the Volunteer Resource Guide (Tab D) includes examples of non-taxable and taxable income.

## How is taxable income calculated on a tax return?

Many of the terms used in this section may not be familiar to you at this time, but they will be covered later in this course.

There are several income terms used on Form 1040: *total income*, *adjusted gross income*, and *taxable income*. Certain personal and business expenses (sometimes referred to as “above the line” deductions) are deducted from total income. Total income is the sum of the items reported in the Income section of Form 1040. This results in an amount called the *adjusted gross income* (AGI). *Taxable income* is calculated by deducting the exemption amount and standard deduction or itemized deductions (sometimes referred to as “below the line” deductions) from the AGI. Taxable income is used to calculate the income tax.

## What is the “bottom line?”

Before arriving at the bottom line (refund amount or balance due) the income tax can be reduced by credits or increased by other taxes to arrive at total tax.

Income tax can be offset by certain designated credits. These credits are *nonrefundable* or *refundable*. Nonrefundable credits cannot be refunded, meaning the amount of the credit cannot be larger than the tax owed. If they are, then they can only reduce the income tax to zero. Refundable credits will enable the taxpayer to receive a refund if the amount of the credit exceeds the amount of tax due. Refundable credits are usually shown in the Payments section of the return.

Form 1040 is used to collect other taxes such as self-employment tax, social security tax on tips, and additional taxes on retirement plans. These taxes are added to the income tax to calculate the total tax due.

Any payments made prior to the filing of the return are recorded on the return to offset the taxes due. These payments can include withholding tax reported on Form(s) W-2, Wage and Tax Statement, various types of Form(s) 1099, or estimated tax payments. Also included are any Earned Income Credit and/or additional child tax credit to which the taxpayer is entitled. If the total tax is less than the total payments, there will be a refund amount. If the total tax is greater than the total payments, there will be a balance due.

## How do I get started?

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To determine a taxpayer’s income, discuss and review Part III, Income, of the approved intake and interview sheet with the taxpayer. Use the interview techniques and tools discussed in the Screening and Interview lesson to probe for this information.

Income is reported on a variety of forms depending on its source. Ask the taxpayer to show you all Form(s) W-2, Form(s) 1099, and others statements reporting income. (Note: Do not confuse Form 1099 with Form 1098. Generally, Form 1098 reports expenses the taxpayer has paid, not income they have received.) You may also find it useful to use page 1 of Form 1040 as a guide to address income items.



**TaxWise Hint:** After you have collected all the income statements, look at the pages Income and How/Where to Enter Income (Tab 2) in the Volunteer Resource Guide. These will show you where to correctly report income items.



## How do I report wages, salaries, tips, etc.?

### What is Form W-2?

Most employers issue a standardized version of Form W-2. Review Form W-2 in the Volunteer Resource Guide under TaxWise Income (Tab 2).

Employers must report wages and other employee compensation on Form W-2 and have it available to the employee by January 31. The employer is not required to mail out Form(s) W-2, but they must make them available to the employees. The employee may need to pick up Form W-2 from their employer.

#### TIP

When you gather Form(s) W-2 and Form(s) 1099 from the taxpayer, verify the SSN on each form and make sure it matches the SSN on the approved intake and interview sheet. If the taxpayer has an ITIN, *DO NOT* enter the social security number that is on Form(s) W-2 on Form 1040. The return is filed using the ITIN only.

### What if the taxpayer does not receive Form W-2 by January 31?

If the taxpayer does not receive Form W-2 by January 31, they should first contact the employer and find out if, or when, Form W-2 was mailed or if the taxpayer can pick up Form W-2 in person. Some employers make Form W-2 available online to their employees as an option.

If Form W-2 is still not received after allowing a reasonable amount of time for the employer to issue or reissue Form W-2, then the taxpayer should contact the IRS for assistance at 1-800-829-1040, but not before February 15.

If, after requesting Form W-2 from the employer, the taxpayer does not receive it in sufficient time to file the return, they should file the tax return with Form 4852, Substitute for Form W-2, Wage and Tax Statement or Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, Etc. The taxpayer should keep a copy of Form 4852 for their records. Usually Form 4852 can be used with a state return as well.

If the employer has ceased operations or filed for bankruptcy, the taxpayer should also file a copy of Form 4852 with the Social Security Administration to ensure proper social security credit.

#### TIP

You always want to stress to the taxpayer that, when they finally receive the employer's Form W-2, if the numbers are different from those on their Form 4852, they need to amend their returns to report the correct amounts.



#### **TaxWise Hint:** Entering Form(s) W-2 into TaxWise:

Look at the Volunteer Resource Guide, TaxWise Income (Tab 2), and find the page titled How/Where to Enter Income.

How do you enter Form W-2 in TaxWise?

Now study the page titled Form W-2 Instructions.

Review the six boxes with statements on the top of the TaxWise Form W-2.

What do you do if Boxes 3, 4, 5 and 6 on Form W-2 do not match box 1 of Form W-2?

What if an address on Form W-2 is different from the taxpayer's correct address?

Is it important to reproduce Form W-2 exactly as it appears?

Once you enter all Form(s) W-2 into TaxWise, the program automatically reports the total on line 7 of Form 1040.

**example**

In 2008, Bob left his old employer and took a job with a new one. He received two Forms W-2, each listing a different address. His return will list his wages as the total of the amounts in Box 1, but each Form W-2 must be entered into the program separately.

**Entering Form(s) W-2 information when preparing a paper Form 1040**

- The amount in box 1 should be entered on line 7 of Form 1040.
- The amount in box 2 should be entered on line 62 of Form 1040.
- The amount in box 8 should be included on line 7 of Form 1040 and on Form 4137.
- The amount in box 9 should be included on line 60 of Form 1040 and check box a for AIEC payments.
- The amount in box 10 should be included on line 14 of Form 2441.
- If there is an amount in box 12 labeled with a "D," complete Form 8880 when you get to the nonrefundable credit section to see if the taxpayer is eligible for the retirement savings contributions credit. Other codes may impact eligibility for the Retirement Saver Contribution credit; check the reverse side of the taxpayer's copy of Form W-2.

**Tip Income**

If the taxpayer has a job in which tips are normally received (i.e. waiter/waitress, bellhop, motel maid, etc.), be sure to ask about any tips they may have received. All tip income is taxable, whether it is reported to the employer or not.

- If individuals who receive more than \$20 per month in tips, while working one job, report their tip income to their employer, the tips will be included with wages on Form W-2, box 1.
- The individual is not required to report tip income of \$20 or less per month while working for one employer. Since these tips are taxable, ask taxpayers if they have any tip income that was not reported to their employer.
- Non-cash tips (for example, tickets or passes) do not have to be reported to the employer, but are included as taxable income at their fair market value.
- Any tip income not reported to the employer is added to other amounts on line 7 of Form 1040.
- If tips were more than \$20 a month, the taxpayer must also pay Medicare and social security taxes on this money. If these were reported to the employer, then they are included in the withholding information. If they were not reported to the employer then complete Form 4137 for the taxpayer.
- Tips of less than \$20 per month or noncash tips must be reported as income on line 7 of Form 1040, but are not subject to social security and Medicare taxes.

Information on how to report unreported tips and pay social security and Medicare taxes on qualifying unreported tips is covered in the Other Taxes lesson. Also, the Volunteer Resource Guide (Tab D) provides detailed information on how to enter unreported tips.

### ***Allocated Tips***

For some businesses, giving employees tips is customary. These businesses include restaurants, bars, and similar businesses. To ensure that everyone reports their fair share of income from tips, some employers have tip allocation programs. These programs are approved by the IRS. If an employee reports tips to the employer that were less than the designated share based on the employer's formula, the employer reports the difference as "allocated tips" and includes it on the employee's Form W-2.

Allocated tips are shown separately in box 8 of Form W-2. Social security and Medicare taxes are not withheld on allocated tips. Allocated tips are not included in the amount in box 1 of Form W-2. Explain to the taxpayer that unless the taxpayer kept a written and reliable record of tips actually received at that job and can prove the allocated amount is inaccurate, the allocated tips must be included in line 7 of Form 1040. If the taxpayer did keep a reliable written record of tips, then their figures are used in place of the amount in box 8 when including tip income on line 7 of Form 1040.



**TaxWise Hint:** When allocated tips are reported in box 8 of Form W-2, TaxWise automatically adds them to line 7 of Form 1040 and TaxWise also completes Form 4137. If this amount is not correct, based on the taxpayer's records, an adjustment will need to be made on Form 4137 in the TaxWise program.



For more information about tip income, see Publication 531, Reporting Tip Income.

Allocated tips are also subject to social security and Medicare taxes. Report the allocated tip amount on Form 4137, along with any unreported tips to calculate social security and Medicare taxes.

### **Other W-2 Income**

#### ***What about income received by household employees?***

The term, "household employee" refers to one who works in someone's home performing household duties such as caring for children, cleaning, or cooking. Generally, if a taxpayer, working as a household employee, earned less than \$1,600 a year while working in the employer's home, the employer is not required to provide the taxpayer with Form W-2. Regardless whether Form W-2 is issued, the income must be included on Form 1040, line 7. However, if the employer withheld federal income taxes from the taxpayer's wages, the employer must issue Form W-2.



**TaxWise Hint:** TaxWise has a separate line under line 7 that reads "Household employees' income not on a Form W-2." To enter the income, link from the box to 1040 Worksheet 1.

If you are preparing a paper return and the taxpayer's household employer is not required to issue Form W-2, enter "HSH" and the amount on the dotted line next to line 7, then include the amount in the total on line 7.

**TIP**

For further information and a definition of who is a household employee, see Publication 926, Household Employers Tax Guide.

## **Are scholarships and fellowships taxable income?**

### ***Form W-2 and Form 1098-T***

Scholarships and fellowships may be fully, partially, or non-taxable. Taxable amounts include:

- Payment for services
- Money used for personal living expenses, such as room and board

If the taxpayer received Form W-2 for the scholarship or fellowship, include the amount on Form 1040 just as you would for any other Form W-2. This income is included in the total on line 7 of Form 1040.

Form 1098-T lists qualified tuition and related expenses billed by the school. Verify that these amounts have been paid. It also lists scholarship and grant money the student received. If scholarships or grants exceed the qualified educational costs, some of the grant or scholarship money may be taxable.

To determine if any scholarship or grant received is taxable, or to determine if the taxpayer can claim an education credit, see Publication 970, Tax Benefits for Education. Education credits will be discussed in a later lesson.



**TaxWise Hint:** Since Form 1098-T is not primarily an income document, there is no Form 1098-T to complete on TaxWise. It is also used to determine education credits the taxpayer might claim. After asking questions about the scholarship/fellowship money, record the taxable portion on the TaxWise 1040 Worksheet 1.

When preparing a paper return, if the taxpayer did not receive Form W-2 for the scholarship or fellowship, report the taxable portion of the scholarship or fellowship on line 7 of Form 1040. Write "SCH" and the amount on the dotted line next to line 7 of Form 1040 and include the amount in the total for line 7.

## **Are distributions from Educational Savings Accounts, such as a Coverdell ESA and 529 plans, taxable?**

Coverdell ESA (section 530 plan) or Qualified Tuition Program (section 529 plan) are educational savings accounts that include the following provisions:

- Money is contributed to a special account.
- The contribution is never deductible.
- Earnings on the after-tax contributions become tax-deferred.

When a distribution is made, none of the money will be taxable as long as it is a qualified distribution. If it is used for qualified education expenses, some of the money that was never taxed (the earnings) becomes taxable income and may be subject to an extra penalty tax.



Distributions from Educational Savings Accounts and Qualified Tuition Programs (under Sections 529 and 530) are reported on Form 1099-Q. Coverdell ESA distributions can be used to pay for qualified elementary, secondary, and postsecondary expenses. Qualified Tuition Program (QTP) plan distributions can only be used to pay qualified postsecondary expenses.

Additional information about educational savings accounts, distributions, and qualified education expenses can be found in Publication 970, Tax Benefits for Education.



**TaxWise Hint:** Form 1099-Q is not available on TaxWise because the form does not contain enough information to determine how much, if any, of the distribution is taxable.

Ask the taxpayer if all the funds were used for qualified educational expenses. (Qualified educational expenses have different requirements for each plan.) If yes, none of the distribution is taxable. You do not report anything on the return.

Refer the taxpayer/beneficiary to a professional tax preparer if:

- The funds were not used for qualified education expenses or
- The distribution was more than the amount of the qualified expenses



A decision can be made to choose to report the taxable part of the distribution (if any) and claim the Hope or Lifetime Learning Credit on the whole distribution. See Publication 17 and Publication 970, Educational Expenses, for more details.

### What about income on Form 1099-MISC?

Generally, you do not report this income on Form 1040, line 7. Form 1099-MISC is used by payers to report many types of income, such as rent, royalties and non-employee compensation. A taxpayer receiving *non-employee compensation* reported in box 7 of Form 1099-MISC is usually considered self-employed or an independent contractor. This income is reported on Schedule C or C-EZ. Because of the complexity of the law, VITA/TCE preparers cannot prepare a Schedule C. They can, however, prepare Schedule C-EZ. Look at a copy of Schedule C-EZ to determine who is allowed to use it. The reporting of self-employment income is taught in Lesson 9.



### What interest is taxable?

Common sources of taxable interest income are checking and savings accounts, certificates of deposit (CDs), savings certificates, U.S. government bonds, interest on insurance proceeds, and loans that the taxpayer makes to others.



Some savings and loans, credit unions, and banks call their distributions “dividends.” These distributions are really interest and are reported correctly as interest on Form 1099-INT.



## Where do I get interest income information?

There are many sources of information about interest income. Ask the taxpayer to supply each of the following:

- Form(s) 1099-INT from institutions that pay interest on bank accounts.
- Original Issue Discount (OID) - long-term obligations that pay no interest before maturity are considered to be issued at a discount.
- If the taxpayer cashed in Series EE or Series I bonds, they should have a form 1099-INT from the bank. Most taxpayers don't report savings bond interest as it accrues every year. They report the total interest when they cash the bonds. If the taxpayer says they have been reporting the interest as it accrues each year, see Publication 17 under Interest Income for directions to report the current year interest.

### TIP

Interest on qualified U.S. Series EE and Series I savings bonds that is used to pay for higher education expenses may be eligible for exclusion from income using Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989.

If a U.S. savings bond is issued in the names of co-owners, such as the taxpayer and child, or the taxpayer and spouse, interest on the bond is generally taxable to the co-owner who purchased the bond. To determine who is responsible for paying the tax on the interest from the redemption of a bond, see Publication 17 under Interest Income.

- If the taxpayer has Series HH bonds, they receive interest twice a year. Ask the taxpayer for the bank statements reporting the interest received.
- Ask if the taxpayer holds any loans or seller-financed mortgages.

### TIP

Some institutions issue a year-end statement with the title "In lieu of Form 1099-INT or Form 1099-DIV" rather than preparing multiple documents.

### example

Bob holds a promissory note for a cash loan that he made to his brother-in-law, Stan. Stan pays Bob principal and interest each month. Bob reports that interest on Schedule B of his tax return.

## What interest income is tax-exempt?

Certain types of interest are exempt from federal income tax. However, it may be taxable by the state, so read the form carefully. (And sometimes the reverse is true, some interest may be taxable on the federal return and exempt from state income tax.)

Interest from bonds issued by the following are exempt from federal income tax:

- State and political subdivisions (county or city)
- District of Columbia
- U.S. possessions and political subdivisions
- Port authorities
- Toll-road commissions
- Utility service authorities
- Community redevelopment agencies

- Qualified volunteer fire departments
- Amounts indicated on broker statements as tax-exempt interest or tax-exempt dividends

The taxpayer's Form(s) 1099-INT may list both taxable and tax-exempt interest. Read the form(s) carefully.

Although tax-exempt interest is not taxable, the taxpayer must report all tax-exempt interest on the tax return on line 8b of form 1040. In some situations, tax-exempt interest, while not taxable, is used in calculating the taxability of other income items, such as social security income.

### What about the interest on an IRA?

Interest on a Roth IRA is generally never taxable.

Interest on a traditional IRA is tax deferred. Do not include that interest until the taxpayer makes withdrawals from the IRA. The taxpayer will be issued a Form 1099-R to report a distribution. See the lesson on Retirement income for the proper way to report this income.

See Publication 17 and Publication 590 for more information on IRAs.

#### example

Mike holds municipal bonds issued in his state, as well as a traditional IRA to which he makes contributions each year. For each of these, he gets statements listing the interest earned. Although not taxable, Mike reports his tax-exempt interest from the municipal bonds on line 8b of his Form 1040. He does not report any of the interest income on his traditional IRA on his tax return.

### How do I report the interest income?



**TaxWise Hint:** Look at the TaxWise Income section of the Volunteer Resource Guide (Tab 2). Look at the page How/Where to Enter Income. Link from Form 1040, line 8a or 8b to Schedule B. From Schedule B, box 1b, link to the Interest Statement.

It is important to make this link. If the taxpayer has multiple accounts, TaxWise adds all the interest for you, preventing math errors. Also, correct use of the worksheet ensures that the income will be taxed correctly and that other entries from Form 1099-INT will be distributed to the proper locations on the return.

If you are preparing a paper return, use Form 1040, Schedule B, or Form 1040A, Schedule 1, if the taxpayer has any of the following:

- Over \$1500 of taxable interest
- Nominee interest
- A seller-financed mortgage
- Tax-exempt interest
- A distribution from a foreign trust or foreign bank account
- Educational savings bond exclusion

Otherwise, you would enter the interest income directly on Form 1040, page 1, line 8a or line 8b or Form 1040A, line 8a or 8b. Amounts in Form 1099-INT, boxes 1 and 3, are reported as taxable interest, and box 8 is reported as tax-exempt interest. Be sure that any other entries on the Form 1099-INT are entered in their proper places on Form 1040, e.g. box 2 goes in the Adjustments section, box 4 goes in the Payments section, and box 6 goes in the Credits section. If any other boxes contain amounts, refer the taxpayer to a professional tax preparer.

## Taxpayer Example

Barbara Smith is a window clerk with the United States Postal Service. She has one Form W-2.

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

#### BARBARA RESPONDS...

*Now we will complete the income section of your return. I believe you told me that you work at the post office?*

Yes. Here is my W-2.

*Are you employed by anyone else?*

No way, they keep me busy enough at the post office!

*Let me enter your Form W-2 information...*

No, I'm not disabled.

*Did you have any disability income?*

*Now, let's go on to interest income. Did you earn any interest on checking accounts, savings accounts, or a certificate of deposit?*

Yes, I have a savings account that earns interest. Here is the 1099.

*What about U.S. savings bonds? I know that a lot of postal employees buy them at work.*

Yes, I do, every pay period.

*Are they for educational purchases, or just an investment?*

No, they aren't educational. I don't have any information about my bonds with me. Why would I need that?

*Some people report the interest as it accrues every year. You have to make this decision in the first year after you buy the bonds. Have you ever declared accrued interest from your savings bonds on your federal tax return?*

Oh, no, never.

*Well, did you redeem any bonds in 2008, or did any of them mature that year?*

No to both questions. I've been buying them for 15 years and they don't become fully mature for 30 years.

*Okay, then it sounds like your only interest income is from the savings account. Let's enter that now.*

[On page 2 of the approved intake and interview sheet, indicate Barbara's responses to these questions.]



## How do I handle dividends?

The corporate distributions that volunteer tax preparers may handle are:

- Ordinary dividends
- Qualified dividends and distributions
- Capital gain distributions

These are all found on Form 1099-DIV.

## What are ordinary dividends?

Ordinary dividends are corporate distributions paid out of the earnings and profits of the corporation. Any dividend received on common or preferred stock is an ordinary dividend unless the paying corporation states otherwise. Total ordinary dividends are reported in box 1a of Form 1099-DIV.

### example

Robert held both common stock and preferred stock in several U.S. corporations. Several of them paid dividends during 2008. In January 2009 he received Forms 1099-DIV listing these as ordinary dividends.



Ask taxpayers if they received distributions from dividend reinvestment, return of capital, or dividends in the form of stock (stock dividends). If so, explain that volunteers are not trained to handle these sources of income. Apologize for being unable to complete the return, and explain that they should seek a professional tax preparer to complete their returns.

## What are qualified dividends?

Qualified dividends are ordinary dividends that are eligible for a lower tax rate than other ordinary income. They are shown in box 1b of Form 1099-DIV.

- See Form 1040 Instructions, Line 9b, for the definition of qualified dividends.

Taxpayers who have questions about why a dividend is “qualified” or “not qualified,” should contact the company that issued the dividend.

## What are capital gain distributions?

Capital gain distributions are also called capital gain dividends. They come from mutual funds and real estate investment trusts (REITs). They are taxed at the lower, long-term capital gains rate, regardless of how long the taxpayer holds the shares. Capital gain distributions are reported in box 2a of Form 1099-DIV.



“Capital gains” and “Capital gain distributions” are not the same. A capital gain occurs when the owner of a mutual fund or other capital asset sells the asset for more than the cost and realizes a capital gain. A capital gain *distribution* is the owner’s portion of the capital gains realized when the mutual fund or REIT sells assets. If the taxpayer has actually sold their mutual fund shares, or other shares of stock, and you are not certified in this area, you should refer them to a VITA/TCE preparer who has been trained to handle capital gains and losses.

### example

During 2008, Robert owned shares in a mutual fund and in a real estate investment trust. Both made capital gain distributions that year. In January 2009, he received Forms 1099-DIV listing these capital gain distributions.

## Where do I get dividend information?

Most corporations use Form 1099-DIV to report dividend distributions to each shareholder. Ask the taxpayer for any Form(s) 1099-DIV. (If the taxpayer did not receive a Form 1099-DIV for a dividend, ask if they received the information on their shareholder's annual brokerage statement.)

## How do I report dividend information?

Generally, all dividend income is reported on these forms:

- Form 1040A, lines 9a and 9b
- Form 1040, lines 9a and 9b

Schedule 1 (Form 1040A) or Schedule B (Form 1040) are needed if the taxpayer's ordinary dividends are greater than \$1,500, or if the taxpayer was the nominee for dividends that actually belong to someone else.



**TaxWise Hint:** Look at the TaxWise Income section of the Volunteer Resource Guide (Tab 2). Look at the page How/Where to Enter Income. Link from Form 1040, line 8a or 8b to Schedule B. From Schedule B, line 5, link to the Dividend Statement. It is important to make this link. If the taxpayer has multiple accounts, TaxWise adds all the dividends for you, preventing math errors. Also, correct use of the worksheet ensures that the income will be taxed correctly and that other entries from Form 1099-DIV will be distributed to the proper locations on the return.

If you are preparing a paper return, be sure the amounts in boxes 1a and 1b of Form 1099-DIV are recorded on the correct lines on the return. Be sure that any other entries on the Form 1099-DIV are entered in their proper places on the Form 1040, e.g. box 2a goes on the Capital Gain line in the Income section unless a Schedule D is required, box 4 goes in the Payments section, and box 6 goes in the Credits section. If any other boxes contain amounts, refer the taxpayer to a professional tax preparer.

If the taxpayer has received a qualified dividend or capital gains distribution, and you are preparing a paper return, the Qualified Dividends and Capital Gain Tax Worksheet is required. The worksheet can be found in Form 1040 Instructions.

## Taxpayer Example

Leonard Stark, Gloria's spouse, is self-employed. They are filing a joint return. Leonard and the volunteer are discussing dividend income.

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Do you and your wife own shares of stock, mutual funds, or bond funds?*

*The earnings on the IRAs are tax deferred until you take a distribution. These 1099-DIVs are what we want right now. Are these the only Forms 1099-DIV that you received?*

*We will enter the information from each of these on the TaxWise Dividend Statement. It will add everything up and display it as your dividend income.*

[On page 2 of the approved intake and interview sheet, indicate Leonard's responses to these questions.]

#### LEONARD RESPONDS...

Yes, I have an IRA and I own shares in several mutual funds and a bond fund. My wife has an IRA. Here are the statements.

Yes.



## What should be reported on line 10 of Form 1040?

Taxpayers who receive a refund of state or local income taxes may receive Form 1099-G listing their refund amount in box 2. Not everyone must include the refund in their taxable income.

- Taxpayers who claimed the standard deduction on the tax return for the year they received a refund of state or local income taxes do not have to include the refund in their taxable income
- Taxpayers who itemized deductions and received a state or local refund may have to include all, part, or none of the refund in their federal taxable income

Only those taxpayers who itemized deductions and received a tax benefit for deducting their state or local income taxes have to include their state/local tax refunds in income. If they itemized deductions and deducted the state sales tax instead of the state income tax withheld, none of the refund is taxable.

When you get to this point in the interview, ask the taxpayer:

- Did you receive a refund for part of your 2007 state and/or local income taxes in 2008?
- If yes, did you itemize your deductions for tax year 2007?
- If yes, did you include the state and/or local income taxes that you paid for that year?
- If yes, use the state tax refund worksheet to see if any of the refund is taxable. In order to complete the worksheet, you will need a copy of the prior year return.

### example

Bob itemized his deductions on his 2007 federal return. He included the taxes he had paid to his state during 2007. However, he received a refund in 2008 on the overpaid portion of those taxes. He must use the state tax refund worksheet to see how much of the refund to include in his federal taxable income.



**TaxWise Hint:** From Form 1040, line 10, link to the state tax refund worksheet. Enter information from the taxpayer's 2007 return. TaxWise then calculates the taxable part of the refund (if any) on line 10 of Form 1040.

When preparing a paper return, complete the State and Local Income Tax Refund Worksheet in Form 1040 Instructions when required.



## What is alimony?

Alimony is a payment to or for a spouse or former spouse under a separation or divorce instrument. It may include payments on behalf of the spouse or former spouse, such as medical bills, housing costs, and other expenses. It does not include child support or voluntary payments outside the instrument. The person receiving alimony must include it as income. The person paying alimony can subtract it as an adjustment to income. This will be discussed in a later lesson.

### Where do I get alimony information?

Ask if the taxpayer received alimony under a divorce or separation instrument. If so, explain that you need the exact amount, since it may also be reported as a deduction by the payer, and the two amounts must agree.

### How do I report alimony?



**TaxWise Hint:** On line 11, enter the alimony amount. There is no worksheet for reporting alimony income, and the social security number of the person paying the alimony is not needed.

When preparing a paper return, record the alimony received by the taxpayer on Form 1040, line 11.



If the taxpayer is unsure whether a payment is alimony or child support, ask if the payments will stop once the child is grown.



This training covers alimony paid under a divorce or separation instrument executed after 1984. Other rules apply to agreements executed before 1985. If the agreement was executed before 1985, refer the taxpayer to a professional tax preparer.





Our volunteer is working with our taxpayer, Vanessa Franklin. Go to Appendix A-12 and review the sample interview to identify Vanessa's wage and interest income.

### Summary

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This lesson covered some general concepts on income for line 7-11 of Form 1040 including how to determine what is considered taxable and nontaxable income. Review the list of taxable and nontaxable income in the Volunteer Resource Guide (Tab D), Income.

How to determine what income is considered earned and unearned was covered. Earned income is any income accumulated by personal effort, such as wages or business income reported on Schedules C or C-EZ. Unearned income is any income produced by investments, such as interest on savings, dividends on stock, etc.

How to report income was also covered. Following is information on how to report income on Lines 7-11 of Form 1040.

- Line 7 income includes wages, salaries and tips, and scholarships. This income is generally reported to the taxpayer on Form W-2.
- Lines 8a and 8b, interest income, is reported to the taxpayer on Form 1099-INT. Common sources of taxable interest income are checking and savings accounts, certificates of deposit (CDs), savings certificates, U.S. government bonds, etc. Interest on certain bonds (such as from state political subdivisions, District of Columbia, port authorities, etc.) are exempt from federal income tax, but must be reported on line 8b.
- Lines 9a and 9b are for reporting ordinary and qualified dividends. Dividends are reported to the taxpayer on Form 1099-DIV. Ordinary dividends are corporate distributions paid out of the earnings and profits of a corporation. Qualified dividends are ordinary dividends that are eligible for a lower tax rate than other ordinary income.
- Line 10 is for taxpayers who itemized deductions in the previous year and received a tax benefit from deducting their state or local income taxes. Taxpayers who receive Form 1099-G may have to include part or all of their state refund on this line.
- Line 11 is used to report alimony received. Alimony is a payment to or for a spouse or former spouse under a separation or divorce instrument.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



## Form 1040, Line 12



### Introduction

This lesson will help you assist taxpayers who have household business income, including self-employment income. Business income or loss is reported on Schedule C-EZ, Net Profit From Business, or Schedule C, Profit or Loss From Business. Schedule C is out of scope for volunteer preparers. The lesson also covers those self-employed taxpayers who pay self-employment tax and participate in the social security and Medicare programs.

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- How to report business income
- Who can use Schedule C-EZ
- How to complete Schedule C-EZ



#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Schedule C-EZ
- ☐ Schedule SE
- ☐ Form 1099-MISC

### Where do I get business income or loss information?

Based on your interview and the completion of the taxpayer's approved intake and interview sheet, you may discover that the taxpayer or someone in the household had business income; this includes income as a self-employed person or independent contractor.

Even if taxpayers say they did not have self-employment income, be sure to ask again, rephrasing your questions to probe deeper. Many taxpayers have jobs on the side or have a small home-based business and do not think of themselves as "self-employed" if they make most of their money from W-2 wages. Ask for any Form(s) 1099-MISC that document this income. Also ask for documentation of any business income that was not reported on Form W-2 or Form 1099-MISC (for example, check stubs generated by the taxpayer's client).



Some employers misclassify workers as independent contractors and report their earnings on Form 1099-MISC. Taxpayers who believe they have been misclassified should contact the IRS and ask for help.

## How is business income or loss reported?

Business income or loss is reported on either:

- Schedule C-EZ, Net Profit From Business, or
- Schedule C, Profit or Loss From Business

The total profit or loss is then transferred to Form 1040, line 12.



Volunteer tax preparers who complete this lesson may, at the discretion of the site coordinator, assist self-employed individuals who qualify to use Schedule C-EZ. Taxpayers who must file Schedule C should see a professional tax preparer.



**TaxWise Hint:** To enter business income or loss, start at Form 1040, line 12, then go to Schedule C-EZ. Once all income and expense information is entered on Schedule C-EZ, TaxWise displays the total on line 12 of Form 1040. In addition TaxWise will calculate the self-employment (SE) tax and the adjustment for half of the SE tax.

If preparing a paper return, complete the items on Schedule C-EZ. The net profit will be reported on Form 1040, line 12. The net profit will also need to be shown on Schedule SE in order to calculate the self-employment tax. Schedule SE will be covered in a later lesson.

## Who can use Schedule C-EZ?

Taxpayers can use Schedule C-EZ only if they meet all the conditions shown in the flowchart in Part I, General Information, on Schedule C-EZ.

- Have less than \$5,000 in business expenses
- Use the cash method of accounting
- Have no inventory at any time during the year
- Have positive net income (do not have a net loss)
- Operate only one business as a sole proprietor during the tax year
- Have no employees during the year
- Are not required to compute depreciation (Form 4562)
- Did not deduct expenses for business use of a home
- Do not have prior year unallowed passive activity losses from this business



Some states do not recognize Schedule C-EZ. In this case a Schedule C must be used. The same conditions apply.

### Definition of Terms

Business expenses	Business expenses are amounts that are ordinary and necessary to carry on the business.
Cash method of accounting	The cash method of accounting reports all income when received and deducts all expenses when paid.
Inventory	Inventory is the items the taxpayer buys or makes for resale to others.
Depreciation	The cost of items that are expected to last more than a year should be spread over a period of years rather than deducted in the year of purchase. If the taxpayer has such a cost, they should be referred to a professional tax preparer.

In your probing interview, explain that there are a number of conditions that the taxpayer must meet in order to use Schedule C-EZ, and then walk through each of these conditions with the taxpayer. If taxpayers do not meet these conditions, explain that volunteers are not trained to handle the preparation of Schedule C. Apologize for being unable to complete the return, and explain that they should seek help from a professional tax preparer to complete their return.

## Taxpayer Example

As you use the approved intake and interview sheet with taxpayers, ask questions to determine if they have any self-employment income, their accounting method, and their business expenses. Use the Interview Tips to help obtain additional information, as shown in this sample interview.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	JASON RESPONDS...
<i>What kind of business do you have and were you the sole owner?</i>	I install air conditioners and yes, I own the business myself. No partners or anything.
<i>Do you have a record of your business income and expenses for last year?</i>	Yeah, I've got a separate checking account for my business. I had a pretty decent first year actually.
<i>Do you use the cash method of accounting?</i>	Yes. I have a printout of my year-end summary here.
<i>And what were your expenses?</i>	Well, I do the installations myself; I don't have any employees, so I spend a lot of money on gas, tools that last less than a year and equipment repairs. My expenses for the year were \$2,212.
<i>Do you keep any parts in inventory?</i>	No, I purchase the parts wholesale when an order is placed with me.
<i>And you say you had a good year? Did you have a net loss? In other words, did you make a profit?</i>	That's correct. No losses.
<i>Do you plan on deducting expenses for the business use of your home?</i>	No I don't.
<i>Okay, and how much business income did you have?</i>	My receipts totaled \$30,762.
[On page 2 of the approved intake and interview sheet, indicate Jason's responses to these questions.]	



### EXERCISE

**Question 1:** Based on this information, does Jason qualify to fill out a Schedule C-EZ? ☐ Yes ☐ No

## How do I complete Schedule C-EZ?

### Part I: General Information

Enter the type of business on line A. Enter the Principal Business Code on line B. A listing of Principal Business Codes can be found in Schedule C Instructions and in Form 1040 Instructions.



**TaxWise Hint:** To find Principal Business Codes, bring up the Help screen while in the Schedule C-EZ. A list is available under Business Codes.

Enter the business name, if there is one, on line C. If the business has an Employer Identification Number (EIN), enter it on line D (most Schedule C-EZ businesses do not need an EIN, since they do not have employees.) If the business has an address that is different from the one shown on Form 1040, enter it on line E.

### Part II: Figure Net Profit

Enter total gross receipts on line 1. This includes all the income paid to the business, whether or not it was reported on a Form 1099-MISC. If any of the income was reported on Form W-2 and the “Statutory employee” box on the form was checked, check the box on line 1 of Schedule C-EZ.



**TaxWise Hint:** If the taxpayer has non-employee compensation reported in box 7 of Form 1099-MISC, link from line 1 of Schedule C-EZ and select *New Miscellaneous Income* from Form 1099-MISC. Complete a separate Form 1099-MISC for each Form 1099-MISC that the taxpayer provides. Include other income not reported on Form 1099-MISC by linking to a new scratch pad. On the new scratch pad, enter a title (the principal business name used on Schedule C-EZ) and the type and amount of each item of business income. By using the linking feature TaxWise will combine all income amounts to be included on line 1 of Schedule C-EZ.

If preparing a paper return, total all income from Form 1099-MISC and other taxpayers records and enter the amount on Schedule C-EZ, line 1.

Enter on line 2 the total amount of all deductible business expenses that the taxpayer actually paid during the year. Only the portion of these costs that are attributable to the business can be deducted as a business expense. Examples of these expenses include advertising, car and truck expenses, commissions and fees, insurance, interest, legal and professional services, office expense, rent or lease expenses, repairs and maintenance, tools that last less than a year, supplies, taxes, travel, the allowable percentage of business meals and entertainment, and utilities. The base rate of the first telephone line to a residence cannot be deducted, but additional costs incurred for business purposes can be included as an expense.

#### example

Kiana runs a small business from her home. She has only one phone line and frequently makes long-distance calls for business. The cost of the phone line cannot be deducted, but Kiana can deduct the long-distance charges for her business calls.

If preparing a paper return, total all the deductible business expenses including auto expenses, calculated by using the standard mileage rate. Record the amount on Schedule C-EZ, line 2. Calculate the net profit by subtracting line 2 from line 1. The net profit is reported on Form 1040, line 12.



**TaxWise Hint:** Link from line 2 to open a New Scratch Pad. After entering a title (same as the principal business name used on Schedule C-EZ), describe each expense and list the amounts for each. TaxWise will total all the expenses and transfer the total to line 2.

Line 2 subtracts the total expenses from the gross receipts to determine the net earnings from self-employment. This amount is carried to line 12 of Form 1040. This amount is used also to compute self-employment tax.

### ***Part III: Information on Vehicles***

If the taxpayer had business expenses for a car or truck, complete the questions in Part III. Business miles do not include commuting miles between home and the business location or between the business location and the lunch place.

Vehicle expenses can be calculated using actual expenses or the standard mileage rate. Actual expenses include depreciation. The calculation of depreciation is outside the scope of the VITA/TCE program. If the taxpayer has used actual expenses in the past, or wishes to use actual expenses in the current year, they must be referred to a professional preparer.

The standard mileage rate (0.505/mile from January 1, 2008 through June 30, 2008; 0.585/mile from July 1, 2008 through December 31, 2008) is multiplied by the number of business miles to calculate the vehicle expense. Add the total vehicle expenses to all non-vehicle expenses in line 2.



**TaxWise Hint:** TaxWise will compute the vehicle expense at the standard mileage rate when Part III is completed. Include this amount by entering the vehicle expense on the Scratch Pad that was opened from line 2; the vehicle expenses amount does not carry forward automatically to line 2.

If preparing a paper return, complete the information in Schedule C-EZ, Part III.

### **What about self-employment tax?**

A taxpayer must file Schedule SE if he or she has net earnings from self-employment of \$400 or more. The tax is computed on Schedule SE and transferred to Form 1040, line 57, to be added to other taxes owed. The Schedule SE is attached to Form 1040, and discussed in Lesson 28, Other Taxes.

Self-employed people may claim an adjustment to income of half of the social security and Medicare taxes they pay. Enter the amount from Schedule SE, line 6, to Form 1040, line 27, as an adjustment to income.



**TaxWise Hint:** Self-employment tax and the adjustment of half of the self-employment tax are automatically calculated and carried to the appropriate forms when using TaxWise.

## Practice – Vanessa Franklin

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Recall that our taxpayer, Vanessa Franklin, is an employee but she also has her own cosmetics business. Go to Appendix A-14 to gather more information about her self-employment income.

## Summary

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This lesson explained:

- Where to get business income and loss information
- How business income or loss is reported
- Who can use Schedule C-EZ
- How to complete Schedule C-EZ



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Intermediate - Yale
2. Advanced - Dalhart
3. Military - Sierra
4. International - Holmes



### EXERCISE ANSWER

**Answer 1:** Yes. Jason meets all requirements to qualify for completing Schedule C-EZ.

## Form 1040, Line 13



### Introduction

This lesson will help you assist taxpayers who must use Schedule D, Capital Gains and Losses, to report capital gains and/or losses on the sale of assets. In this lesson we will discuss the sale of stock and the sale of a personal residence. If the taxpayer has sold any other assets refer him/her to a professional tax preparer. This lesson will help you identify the asset's holding period, adjusted basis, net short-term and long-term capital gains or losses, the taxable gain or deductible loss, the tax liability, and the amount of any capital loss carryover.

Sale of stock is reported to the taxpayer on Form 1099-B, Proceeds From Broker and Barter Exchange Transactions. These transactions must be reported on Form 1040, Schedule D. The taxable gain or loss from the sale of investment property can only be reported on Form 1040, Schedule D.

To determine if the taxpayer must report the sale of investments or the sale of a home, use the interview techniques and tools discussed in the lesson, Screening and Interviewing. The approved intake and interview sheet does not list income from the sale of property, but it is important to ensure that all income is accurately reported on the return. Ask taxpayers if they sold any stock, securities, other investment property, or a home during the tax year.

For additional information on the topics discussed in this lesson, see Publication 544, Sales and Other Dispositions of Assets, Publication 551, Basis of Assets, and Publication 523, Selling Your Home.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine the adjusted basis of stock
- Determine if the asset's holding period is long-term or short-term
- Calculate the taxable gain or deductible loss from the sale of stock
- Determine whether a home is the taxpayer's main home
- Determine if a taxpayer meets the ownership and use tests
- Determine when the 5-year ownership/use test period is suspended

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Schedule D

#### **Optional:**

- ☐ Publication 523
- ☐ Publication 544
- ☐ Publication 551
- ☐ Form 1040 Instructions
- ☐ Form 1040 (Schedule D)
- ☐ Form 1099-B
- ☐ Form 1099-DIV
- ☐ Form 1099-S

## What information must I have to report a capital gain or loss?

---

To report capital gain or loss on Form 1040, Schedule D, you will need to identify:

- Basis and/or Adjusted Basis:
  - Basis is the original cost of the asset
  - Adjusted basis includes original cost plus any increases or decreases to that cost (such as commissions, fees, depreciation, deductible casualty losses, insurance reimbursements, major improvements, etc.)
- Holding period:
  - Short-term property is held one year or less
  - Long-term property is held more than 1 year
- Proceeds from the sale:
  - Form 1099-B reflects gross or net proceeds for a stock
  - Form 1099-S usually reflects gross proceeds
  - Other evidence in the absence of the above



**TaxWise Hint:** After you enter the date acquired, date sold, sales price, and basis or adjusted basis into the Schedule D Capital Gain worksheet, TaxWise determines the holding period and calculates the net capital gain or deductible loss. The net capital gain or allowable loss is reported on Form 1040, Line 13.



### EXERCISES

Answers are after the lesson summary.

**Question 1:** Which of the following taxpayers is required to file Form 1040 and Schedule D?

- A. Marriah, who received one Form 1099-B and no Forms 1099-DIV
- B. Lorraine, who received Forms 1099-DIV for capital gain distributions from three different mutual funds
- C. Both of the above

## What is a the basis of stock?

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### Basis

In order to compute gain or loss on a sale, taxpayers must provide their basis in the sold property. The basis of property is usually its cost.

- If taxpayers need help determining their basis and do not have the original purchase documents, refer them to their stockbroker.
- If taxpayers cannot provide their basis in the property, the IRS will deem it to be zero.

If the taxpayer acquired the stock by means other than a purchase, such as a gift, inheritance, or employee stock option plan (ESOP), and does not know the basis of the stock, you will need to refer them to a professional tax preparer. The determination of basis in these situations is beyond the scope of VITA/TCE.



## Adjusted Basis

An adjustment to basis may include additional commissions or fees paid to the broker at the time of purchase or sale.

Events after the purchase of stock can require adjustments (increases or decreases) to the per share basis of stock.

Stock is bought and sold in various quantities. It is important for the taxpayer to keep track of the basis per share of all stock bought and sold. The original basis per share can be changed by events such as stock dividends, stock splits, and DRIP (dividend reinvestment plan) accounts.

- Stock dividends are issued in lieu of cash dividends. These additional shares increase the taxpayer's ownership so the original basis is spread over more shares, which decreases the basis per share.
- Stock splits are decided by the corporation as a way to bring down the market price of stock. A two for one stock split will decrease the basis per share by half. The original basis of \$200 for 100 shares becomes \$200 for 200 shares.
- DRIP accounts leave cash dividends with the company for the purchase of additional shares. Even though these shares are from the same company, they retain their own individual basis separate from the original purchase. Each new purchased share could have a different basis.



Although stock splits and stock dividends do not occur often, always ask taxpayers if they received any additional shares from a stock split or stock dividend.

### example

Alice paid \$1,100 for 100 shares of ABC, Inc. stock (which included the broker's commission of \$25). The original basis per share was \$11 ( $\$1,100/100$ ). She received 10 additional shares as a tax-free stock dividend. Her \$1,100 basis must be allocated to the 110 shares (100 original shares plus the 10-share stock dividend). This results in an adjusted basis of \$10 per share ( $\$1,100/110$ ).

## Basis Other than Cost

There are times when cost alone cannot be used as basis. In some cases, the fair market value (FMV) or adjusted basis is used.

- Property Received as a Gift - To determine the basis of property received as a gift, taxpayers must know its adjusted basis to the donor just before it was given to the taxpayer. Taxpayers also need to know the FMV at the time of the donation and the amount of any gift tax paid on the donation. Determination of the adjusted basis of property received as a gift can be very complex. It is beyond the scope of VITA/TCE.
- Inherited Property - The basis of inherited property is generally the FMV of the property on the date of the decedent's death. However, this can vary if the personal representative of the estate elects to use an alternate valuation date or other acceptable method. If the basis of the inherited property is determined by a method other than the FMV of the property on the date of the decedent's death, it is beyond the scope of VITA/TCE. The taxpayer will need to be referred to a professional tax preparer.

For additional information on how to figure the basis, refer to the Basis of Property chapter in Publication 17, Your Federal Income Tax for Individuals.

## How do I determine the holding period?

---

### Long-Term or Short-Term

Schedule D requires entries for the stock purchase and sale date. Taxpayers must provide the date the stock was acquired and Form 1099-B will indicate the date the stock was sold. These two dates will determine the holding period. Schedule D classifies capital gains and losses as either long-term or short-term, depending on how long the taxpayer owned the stock.

- Stock held for one year or less has a short-term holding period
- Stock held for more than one year has a long-term holding period

The holding period begins the day after the shares were purchased and includes the day the shares were sold. If investment property is inherited, the capital gain or loss is treated as long-term. This is true regardless of how long the property is held.

Determining the correct holding period is important because short-term gains are taxed at regular income tax rates and long-term gains are taxed at a lower rate than the other income reported on the return.

Stock acquired as a stock dividend or stock split has the same holding period as the original stock owned. They are considered to have been acquired on the same day as the original stock. Stock acquired in a DRIP has its own purchase date.

#### example

Erma bought stock on January 11, 2007 (trade date). Her holding period began the next day, January 12, 2007. If she sold that stock on January 11, 2008, she would own the stock exactly one year, and the holding period would be short-term. However, if she sold the stock on January 12, 2008 or later, the holding period would be one year and one day, which constitutes long-term.

#### example

On February 18, 2002, Lenny bought 500 shares of XYZ Corporation stock for \$1,500, including his broker's commission. On April 6, 2008, XYZ distributed a 2% tax-free stock dividend (10 shares). Three days later, Lenny sold all his XYZ stock for \$2,030.

Although Lenny owned the 10 shares for only three days, all the stock has a long-term holding period. Because he bought the stock for \$1,500 and then sold it for \$2,030 more than a year later, Lenny has a long-term capital gain of \$530 on the sale of his 510 shares.

If taxpayers do not have the purchase documents showing date of purchase and cost, refer them to their stockbroker or financial planner.

For additional information on the holding period and other tax consequences of selling or trading investment property, refer to the Sale of Property Chapter in Publication 17. Some of these issues and transactions, such as like-kind exchanges, wash sales, and worthless securities can be complex. Refer taxpayers with these issues to a professional tax preparer.

## What about mutual funds?

Owners of mutual funds may receive both Form 1099-DIV and Form 1099-B. Form 1099-DIV reports capital gains distributions from sales of stock held by the mutual fund. Profits of these sales are reported to the shareholders of the fund as capital gains distributions. If taxpayers (owners) decide to sell any of their shares in the mutual fund itself, then Form 1099-B will be issued. The taxpayer will receive a transaction statement that generally shows the basis of the shares and the short- or long-term gain or loss.

## Specific Identification

Some taxpayers may own shares of stock they bought on different dates or for different prices. This means they own more than one “block” of stock. Each block may differ from the others in its basis (the amount paid for the stock), its holding period (long-term or short-term), or both.

In directing a broker to sell stock, the taxpayer may specify which block, or part of a block, to sell. If the taxpayer does not do this, the shares sold are treated as coming from the earliest block purchased (FIFO method – or First In, First Out). To be valid, the specification must be made before or at the time of sale, **not** after the sale.

### example

In 1998, Marie bought 100 shares of Antrim Corporation stock for \$2,000. In 1999, she bought another 100 shares of Antrim for \$2,300. In 2008, she sold 100 shares of Antrim for \$3,000, but she did not identify the specific block at the time of sale.

Because Marie purchased the earliest block of 100 shares at \$2,000, the adjusted basis of the shares she sold was \$2,000. The sales price of the 100 shares sold was \$3,000. Marie had a long-term capital gain of \$1,000.

However, if she had told her broker to sell the 100 shares bought in 1999, the adjusted basis would have been \$2,300, giving Marie a long-term capital gain of \$700.

## What information do I need from Form 1099-B?

Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, is prepared by the broker who handled the sale of stock. If there are entries in boxes 3, 9, 10, 11, or 12, refer the taxpayer to a professional tax preparer. (To see a copy of Form 1099-B, refer to Advanced Comprehensive problem for Dalhart in Publication 4491-W.)

### Sales Date

In box 1 on Form 1099-B, the stockbroker reports the date the stock was sold. Use this date, along with the purchase date provided by the taxpayer, to determine the holding period.

### Sales Price

In box 2 on Form 1099-B, the stockbroker reports the sales price of the stock, and checks a box to indicate if the amount in box 2 is gross proceeds or net proceeds:

- If Gross proceeds is checked, ask the taxpayer for the amount of commissions/fees paid and add it to the taxpayer's basis
- If gross proceeds less commissions and option premiums (net proceeds) is checked, the broker already subtracted the commissions and fees from the proceeds

### example

Richard sold stock for \$2,300. He paid his broker a commission of \$35 on the sale and received net proceeds of \$2,265. Richard's broker has reported the gross proceeds, so:

- Box 2 of Form 1099-B showed \$2,300
- The box next to "Gross proceeds" is checked

Because box 2 shows *gross* proceeds, you need to add the broker's commissions and fees (\$35) to Richard's basis in the stock.

		Form <b>1099-B</b>	
		2 Stocks, bonds, etc.	Reported to IRS <input checked="" type="checkbox"/> Gross proceeds <input type="checkbox"/> Gross proceeds less commissions and option premiums
		\$ <b>2,300</b>	
PAYER'S federal identification number	RECIPIENT'S identification number	3 Bartering	4 Federal income tax withheld

If preparing a paper return, add the broker's commission and fees (\$35) to the basis and enter the total in column e in Part I or Part II of Form 1040, Schedule D.



**TaxWise Hint:** You will need to add the broker's commissions and fees (\$35) to Richard's basis in the stock before entering the amount on the Capital Gain or Loss Transactions Worksheet.



### EXERCISES (continued)

**Question 2:** Kevin paid his broker a \$75 fee on the sale of his stock. Box 2 of his Form 1099-B shows \$925, and the box next to "Gross proceeds" is checked. What is the amount of Kevin's actual sales price from the sold stock?

- A. \$925
- B. \$1,000
- C. \$850
- D. \$75

### Other Information

Form 1099-B does not report the date the stock was originally purchased, the original purchase price, or any adjustments to the basis. The taxpayer must provide you with that information.



Some brokers do not issue standard Forms 1099-B. Instead they issue a statement, sometimes entitled a "1099 Consolidated Statement," which shows stock sales and other types of distributions, such as dividends and interest.

Thelma Emerson 123 Any Street Your City, State Zip Account Number: 1234-5678-9012 SSN: XXX-XX-XXXX		ABC Investments 456 Main Street Your City, State Zip Phone (XXX) XXX-XXXX FEIN: XX-XXXXXXX		2008 12-31-08	
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Substitute 1099-B					
Date of Sale Box 1a	Stocks, Bonds-Proceeds Box 2 (less commission)	Description Box 7	Federal Income Tax Withheld Box 4		
2-23-08	\$ 2,100.00	20 shares Tractor Company	\$0.00		
6-1-08	\$ 900.00	100 shares Car Company	\$0.00		
6-22-08	\$14,000.00	500 shares Couch Company	\$0.00		
7-5-08	\$ 2,000.00	25 shares Technology Company	\$0.00		

Substitute 1099-DIV					
Payer	Ord. Div. Box 1a	Qual. Div. Box 1b	Cap. Gain, Dist. Box 2a	FIT Withheld Box 4	Foreign Tax Box 6
Car Company	\$ 45.00	\$ 45.00	\$ 0.00	\$0.00	\$ 0.00
Couch Company	\$910.00	\$910.00	\$ 0.00	\$0.00	\$ 0.00

## How do I enter data on Schedule D, Parts I and II?

Information from Form 1099-B is entered on Schedule D. Part I is for short-term sales and Part II is for long-term sales.



**TaxWise Hint:** From the Description of Property column in Schedule D Part I or II, link to the Capital Gain or Loss Transaction Worksheet. Volunteer Resource Guide Tab 2 contains hints on how to enter the information from Form 1099-B.

Capital Gain or Loss Transaction Worksheet column:	Enter information from:
(a) Description of Property	Form 1099-B, boxes 5 and 7: Identify the stock by using the number of shares and the stock symbol i.e., 100 sh XYZ
(b) Date Acquired	Taxpayer's records
(c) Date Sold	Form 1099-B, box 1a
(d) Sales Price	Form 1099-B, box 2
(e) Cost or other basis	Taxpayer's records; include the original purchase price of the stock, with all commissions or fees
(f) Gain or Loss	Automatically calculated

When preparing a paper return, determine the holding period for each block of stock sold. This will indicate whether the sale should be reported in Schedule D Part I (short term) or Part II (long term). Record the information on each sale in columns a-e and calculate the gain or loss for column f.

## How do I report capital gain distributions?

Capital gains distributions are reported to the taxpayer on Form 1099-DIV. If there are no capital gains from the sale of property, the Form 1099-DIV amount is entered directly on Line 13 of Form 1040.

If a taxpayer has both a 1099-DIV *and* a Form 1099-B, then capital gains distributions are added to Schedule D in Part II, Line 13.



**TaxWise Hint:** If the source document (Forms 1099-DIV and 1099-B) are recorded properly in the tax preparation program, then the numbers will be reported in the proper places. The amount from Form 1099-DIV, box 2a will be entered on the Dividend Statement for Schedule B (along with the other information) and will automatically carry over to the capital gain distributions line (Line 13) in Part II of Schedule D.

#### example

Eldridge received a Form 1099-DIV. Box 2a shows he received a total capital gain distribution of \$170.

Eldridge also received a Form 1099-B that shows a net sales price of \$1,200 on the sale of 600 shares of ABC Group, Inc. He bought the stock on February 19, 2003, and sold it on August 25, 2008. His basis in ABC, including commission, is \$1,455.

Eldridge must use Schedule D to report his capital gain distribution because he sold stock that must be reported on Schedule D.

### How do I complete reporting of capital gain or loss?

Combining all the amounts in column f on Schedule D, Part I, results in a net short-term capital gain or loss. Combining all the amounts in column f on Schedule D, Part II, results in a net long-term capital gain or loss.

The combination of the net short-term and net long-term capital gains or losses impacts the tax liability. If there is a combined net capital loss in excess of \$3,000 (or if Married Filing Separately, in excess of \$1,500), then the excess is carried to the next tax year and forward until exhausted. Carryover losses retain their original holding period.

#### example

Bill bought 1,000 shares of stock for \$15,000 (including commission). One year later he sold 600 shares of the stock for \$7,800, net proceeds. Bill had a net loss of \$1,200 as shown below:

$$\text{Basis} = (\$15,000 \div 1,000) \times 600 = \$9,000$$

$$\text{Sales Price} = \$7,800$$

$$\text{Gain or Loss} = \text{Sales Price} - \text{Basis} = \$7,800 - \$9,000 = -\$1,200$$

Bill had a short-term loss of \$1,200.

#### example

Margo bought stock for \$1,500, plus a \$25 commission. 18 months later she sold all the stock for \$2,000 and paid a \$25 commission. Her Form 1099-B shows the gross proceeds of \$2,000 as the sales price.

$$\text{Basis} = (\$1,500 + \$25 + \$25) = \$1,550$$

$$\text{Sales Price} = \$2,000$$

$$\text{Gain or Loss} = \text{Sales Price} - \text{Basis} = \$2,000 - \$1,550 = \$450$$

Margo had a long-term gain of \$450.





## EXERCISES (continued)

**Question 3:** Stella's adjusted basis for 600 shares of KLM Corporation stock she purchased in June 2002 and sold in March 2008 was \$2,400. If Stella sold the 600 shares for \$4,400 and paid a \$100 commission, then what was the sales price for the shares and the amount of capital gain?

- A. \$4,400 sales price and \$2,000 gain
- B. \$4,400 sales price and \$1,900 gain
- C. \$4,500 sales price and \$2,100 gain
- D. \$4,300 sales price and \$1,900 gain

### How do I calculate and report a carryover of a capital loss?

A taxpayer cannot take net losses of more than \$3,000 (\$1,500 for married taxpayers filing separately) in figuring taxable income for any single tax year. The allowable loss is referred to as the deduction limit. Unused losses can be carried over to later years until they are completely used up. The carryover losses are combined with the gains and losses that actually occur in the next year. If a taxpayer has no tax liability or does not file a return for an interim year, the loss carryover is still reduced by \$3,000.

### Capital Loss Carryover Worksheet

To figure any capital loss carryover from 2007 to 2008, use the Capital Loss Carryover Worksheet from the 2008 Schedule D instructions. To complete the worksheet, you will need information from the 2007 return.

If TaxWise was used to prepare the 2007 return, ask the taxpayer for a copy of the TaxWise Schedule D Worksheet 2 (Capital Loss Carryovers from This Year to Next Year) to determine the carryover amounts from 2007 to 2008.

- Enter short-term capital loss carryovers (from Schedule D Worksheet 2, Line 8) on Schedule D, Part I, line 6
- Enter long-term capital loss carryovers (from Schedule D Worksheet 2, Line 14) on Schedule D, Part II, line 14

If the taxpayer's 2008 capital loss exceeds the deduction limit and the remainder must be carried forward to 2009, remind the taxpayer to bring a copy of the 2008 return when the 2009 return is prepared. Make a note on the outside of the taxpayer's tax return record envelope to help alert next year's preparer. Next year, whoever assists the taxpayer will use the Capital Loss Carryover Worksheet in the 2009 Schedule D instructions or the printed copy of the Schedule D Worksheet 2 to figure how much capital loss the taxpayer can carry over from 2008 to 2009.

If preparing a paper return, complete the Capital Loss Carryover Worksheet in the Form 1040 instructions. For additional information on Schedule D, capital gains and losses, and carryovers, refer to the Reporting Gains and Losses chapter in Publication 17.



**TaxWise Hint:** TaxWise automatically calculates the taxpayer's capital loss. If the loss is over the limit, TaxWise reports the maximum allowable deduction. The remainder can be carried over to future tax years.

## Taxpayer Example

Our taxpayers Jeremy Dalhart and Janice Smith checked the “Yes” box for interest/dividend income, so our volunteer asks for details. (See Advanced Comprehensive Problems in Publication 4491-W.)

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Previously we discussed your dividends from the Pembroke Fund, reported on Form 1099-DIV. Did you have any other income from the sale of stock, securities, or other investments?*

*Do you have a 1099 for that?*

*[Later in interview] Earlier, you gave me this 1099-DIV from a mutual fund and these 1099-B forms from the stocks you sold. We already included the capital gain distribution from the mutual fund when we entered the dividends. We'll enter the stock sale information on Schedule D Capital Gain or Loss Worksheet. I see the broker's statement has the sale details I need, but do you know when you purchased the Purdue stock?*

*I see the sale date was March 10, 2008. That means the holding period for the stock was more than one year. They call that long-term and it determines both where we enter the information on Schedule D and the tax rate for any gain. Now, do you know the basis for the stock?*

*That's what it cost you, including any broker fees or commissions.*

*Have you had any other costs related to the stock since then, such as additional fees?*

*That means that the basis for the stock is \$10,123. The 1099-B shows that you received gross proceeds of \$8,859 when you sold the stock. We'll put all these numbers into this worksheet on TaxWise. As you can see, TaxWise has calculated your net loss; this is the sale price minus the basis, for a net loss of \$1,264. After I enter these other transactions from the broker's statement, we'll get a final net gain or loss on Schedule D. This will determine the amount that will be reported on Form 1040, line 13.*

*[On page 2 of the approved intake and interview sheet, indicate Jeremy's responses to these questions.]*

#### JEREMY RESPONDS...

Yes, I sold some stock this year.

Yes, I have this Form 1099-B from Pelrum and this stock-broker's statement.

I bought the Purdue stock back on July 13, 1998.

What is that?

Yes, it cost \$10,053, plus I had to pay \$35 in fees.

No, that's it. Wait, when I sold it, I had to pay \$35 more.



## Who must file Schedule D for the sale of a home?

Now we will discuss if the sale of the taxpayer's residence will need to be reported on Schedule D. You will need to identify whether the home was the taxpayer's main home, if the taxpayer meets the ownership and use tests, and if the gain is more than the allowed exclusions amount. For additional information to help you make this determination, refer to the Selling Your Home Chapter in Publication 17 or Publication 523.

To determine if the taxpayer meets the criteria for reporting the sale of a home, use the interview techniques and tools discussed in the Screening and Interviewing lesson. The approved intake and interview sheet does not list income from the sale of home, but it is important to ensure that all income is accurately reported on the return.

Ask taxpayers if they sold their principal residence or "main home" during the tax year. The taxpayer may be eligible to exclude all or part of the gain from their taxable income.



Scope is very limited on foreclosures in the VITA/TCE Program. Under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude certain debt forgiven on their principal residence.

## Who must report the sale of a home?

Taxpayers must report the sale of a home when one of the following is true:

1. The taxpayer does not meet the ownership test
2. The taxpayer does not meet the use test
3. During the two-year period ending on the date of the sale, the taxpayer has excluded the gain from the sale of another home
4. The gain from the sale is more than the amount that the taxpayer may exclude: \$250,000 for individual taxpayers, \$500,000 for Married Filing Jointly

## What is considered a "main" home?

Only a gain from the sale of a taxpayer's main home may be excluded from the taxpayer's income; a gain from a sale of a home that is *not* the taxpayer's main home will generally have to be reported as income.

So the first step is to find out if the home meets the definition of a "main" home.

A taxpayer's main home is where the taxpayer lives most of the time. It does not have to be a traditional house; for example, it may be a houseboat, mobile home, cooperative apartment, or condominium and must have cooking, sleeping, and bathroom facilities. Their main home may also be a rented house or apartment. Taxpayers who have more than one home, cannot choose which home to designate as their main home.

### example

Lucille owns a home in a Colorado ski area (the ski home). She stays at the ski home most weekends and spends the entire months of December, January, and February there. When she is not at the ski home, she lives in a four-room apartment that she rents in Denver. For over half the year, she lives in Denver. Lucille's main home is her rental apartment in Denver, because she lives there most of the time, even though she does not own the apartment in Denver.

## What are the ownership and use tests?

To claim the exclusion on the gain from the sale of a home, the taxpayer must meet the ownership and use tests. This means that during the five-year period ending on the date of the sale, the taxpayer must have:

- Owned the home for at least two years (the ownership test), and
- Lived in the home as his or her main home for at least two years (the use test)

There are special rules for Armed Forces, intelligence personnel and Peace Corps volunteers in the application of the five-year period. See “Five-year Test Period Suspension - Armed Forces Personnel” at the end of this lesson. Refer these taxpayers to a military certified volunteer or to a professional tax preparer.

The required two years of ownership/use do not have to be continuous. Taxpayers meet the tests if they can show that they owned and lived in the property as their main home for either a total of 24 full months or 730 days (365 x 2) during the five-year period ending on the date of sale. Short, temporary absences are counted as periods of use even if the property is rented during those absences.

Ownership and use tests can be met during different two-year periods. However, a taxpayer must meet both tests during the five-year period ending on the date of the sale.

### example

In 2000, Helen lived in a rented apartment. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 2005. In 2006, Helen became ill and on April 14 of that year she moved into her daughter's home. On July 10, 2008, while still living in her daughter's home, she sold her apartment.

Helen can exclude all the gain on the sale of her apartment because she met the ownership and use tests. Her five-year period is from July 11, 2003, to July 10, 2008, the date she sold the apartment. She owned her apartment from December 1, 2005, to July 10, 2008 (over two years). She lived in the apartment from July 11, 2003 (the beginning of the five-year period), to April 14, 2006 (over two years).

## Reduced Exclusion

Taxpayers who owned and used a home for less than two years (and so do not meet the ownership and use test) may be able to claim a reduced exclusion under certain conditions. These include selling the home due to a change in place of employment (beyond a certain distance), health, or unforeseen circumstances. If any apply, refer the taxpayer to a professional tax preparer. Reduced exclusion computations/determinations are beyond the scope of VITA/TCE.

### example

Jennifer, who is single, bought her first home in August 2006. In December 2007, the company she worked for notified her that she would be transferred to another town by the end of 2008. She continued to live in the home until June 2008, when she sold it at a gain and moved 500 miles to the new town. Jennifer owned and lived in the home less than two years, so she does not meet the ownership and use tests. However, she may qualify to exclude all or part of the gain because she sold the home due to a change in place of employment. Jennifer should be referred to a professional tax preparer.



## EXERCISES (continued)

**Question 4:** Emily, who is single, bought a home in 1996. She lived in the home until May 31, 2006, when she accepted an assignment with the Peace Corps in Venezuela and left the house vacant. Emily returned to her home on May 31, 2007 and lived there until she sold the house on January 10, 2008. Does Emily meet the ownership and use test? ☐ Yes ☐ No

### Prior Exclusions

In addition, during the two-year period ending on the date of the sale, the taxpayer must not have claimed an exclusion on a gain from the sale of another home.

### Married Homeowners

The ownership and use tests are applied somewhat differently to married homeowners. Married homeowners can exclude up to \$500,000 if they meet *all* of these conditions:

- They file a joint return
- Either spouse meets the ownership test
- Both individuals meet the use test
- Neither one excluded gain in the two years before the current sale of the home

If either spouse does not satisfy all these requirements, they cannot claim the maximum exclusion (\$500,000). The most they can claim is the total of the maximum exclusions each would qualify for if not married and the amounts were figured separately. For this purpose, each spouse is treated as owning the property during the period that either spouse owned the property. This calculation is outside the scope of VITA/TCE.

#### TIP

Beginning with main home sales after 2007, the maximum exclusion (\$500,000) by an unmarried surviving spouse is allowed if the sale occurs no later than 2 years after the date of the other spouse's death and all other requirements must be met.

### How do I figure the gain (or loss) from the sale of a home?

Once you've determined that a taxpayer is eligible for the exclusion, you can figure the gain (or loss) on the sale based on the selling price, amount realized, basis, and adjusted basis. If the selling price of the taxpayer's home is less than the allowable exclusion (\$250,000 if Single, \$500,000 if Married Filing Jointly), you do not need to calculate the gain on the sale of the home. None of the gain will be taxable. Loss on the sale of a residence is not reported on the return. For more information, see the Selling Your Home section in Publication 17.

#### TIP

If the taxpayer used the home for business purposes or as rental property after May 6, 1997 they should be referred to a professional tax preparer. The taxpayer cannot exclude the part of the gain equal to the depreciation allowed or allowable as a deduction.

### Selling Price

The selling price is the total amount the taxpayer (seller) received for his or her main home. It includes money, all notes, mortgages, or other debts taken

over by the buyer as part of the sale, and the fair market value of any other property or services that the seller received.

If the taxpayer received Form 1099-S, Proceeds from Real Estate Transactions, use it to figure the selling price. Box 1 shows the date of sale (closing) and box 2 shows the gross proceeds received from the sale of the home. For taxpayers who did not receive a Form 1099-S, use sale documents and other records.



If the taxpayer can exclude the entire gain from the sale of a personal residence, the person responsible for closing the sale (for example, a real estate broker or settlement agent) generally will not issue a Form 1099-S. If a Form 1099-S is issued and you determine that the gain is excludable, the sale must be shown on Schedule D to notify IRS that the gain is excludable.

## Amount Realized

The amount realized is the selling price minus selling expenses (commissions, advertising fees, legal fees, and loan charges paid by the seller, such as points). Amount realized can be calculated using Worksheet 2, Gain or (Loss), Exclusion, and Taxable Gain on Sale of Home, in Publication 523. (A similar worksheet is available in TaxWise.)

Amount realized = Selling price - Selling expenses

\$246,000 = \$250,000 - \$4,000



## EXERCISES (continued)

**Question 5:** Jan meets the eligibility requirements for claiming the exclusion on the gain from the sale of his home. The selling price of the home was \$195,000. The selling expenses were \$15,000. What is the amount realized in this sale? \_\_\_\_\_

## Basis

The basis in a home is determined by how the taxpayer obtained the home. If a taxpayer bought or built a home, the basis is what it cost the taxpayer to buy or build that home. If the taxpayer inherited the home, the basis is its fair market value on the date of the decedent's death, or on the later alternate valuation date chosen by the representative for the estate.



Alternative valuation issues and determining the adjusted basis of property received as a gift can be very complex and are outside the scope of this training. Advise the taxpayer to seek assistance from a professional tax preparer.

## Adjusted Basis

The adjusted basis is the taxpayer's basis in a home increased or decreased by certain amounts.

Increases include additions or improvements to the home such as installing a recreation room or putting on a new roof. In order to be considered an increase, the improvement must have a useful life of more than one year. Repairs that maintain the home in good condition are not considered improvements and should not be added to the basis of the property.

Decreases to basis include deductible casualty losses and gains a taxpayer postponed from the sale of a previous home before May 7, 1997. Decreases can also include depreciation during the time the home was used for business purposes or as rental property. If this is the case, the taxpayer needs to be referred to a professional tax preparer.

Adjusted basis = Basis + Increases - Decreases



To figure the adjusted basis of a home, use Worksheet 1, Adjusted Basis of Home Sold, in Publication 523.

## How much of the gain from a home sale can a taxpayer exclude?

Once you've determined the gain (or loss) on the sale of a taxpayer's main home, you next figure the exclusion and any taxable gain from the sale.

If all the requirements are met, an individual taxpayer may exclude up to \$250,000 of the gain from taxable income; taxpayers who are Married Filing Jointly may exclude up to \$500,000.



Use Worksheet 2, Gain or (Loss), Exclusion, and Taxable Gain on Sale of Home in Publication 523 to figure the gain or loss, the exclusion, and the taxable gain from a sale. Note that line 3 is the amount realized, line 4 is the adjusted basis, and line 5 is the amount of gain or loss from the sale.

## Where do I report any taxable gain from the sale of a home?

Proceeds from the sale of a main home that meets the ownership and use tests must be reported only if the gain is greater than the taxpayer's allowed exclusion; only the excess must be reported. Gain from the sale of a home that is *not* the taxpayer's main home will generally have to be reported as income.

In both cases, the gain is taxable gain and must be reported on Schedule D, Capital Gains and Losses. If the home was used for business purposes or as rental property the gain would be reported on Form 4797 and the taxpayer should be referred to a professional tax preparer.

If the amount realized is less than the adjusted basis, the difference is a loss.

A loss on the sale of your main home cannot be deducted.



**TaxWise Hint:** Link to Schedule D Worksheet 2 and use the Sale of Your Home Worksheet to determine the amount of the gain. The worksheet does not automatically carry the gain to Schedule D. If the taxpayer has a taxable gain, you will need to enter the information from the Sale of Your Home Worksheet in Part I or II of Schedule D and show any portion of the Section 121 Exclusion for which the taxpayer qualifies. TaxWise requires a sale and purchase date on the line with the exclusion amount and a cost basis of \$0.

If preparing a paper return, complete Schedule D, Part II, as shown in the following illustration.

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year					
(a) Description of property. (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-7 of the instructions)	(e) Cost or other basis (see page D-7 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)
8					
Main Home	09/03/1993	07/07/2008	789,000	226,000	563,000
Section 121 Exclusion					(500,000)

## Taxpayer Example

Look at the approved intake and interview sheet for our taxpayer, Jeremy Smith.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

JEREMY RESPONDS...

Did you sell a home during 2008?

Yes, I was going to mention that to you because I should get a tax break on that.

Well, you may be able to exclude all or part of your gain from that sale, but to find out, I have to ask you a few questions.

Three and a half years. We bought it in January 2005 and sold it in June 2008.

First, how long did you own the home?

And was it the main place you lived for at least two years of that time?

Well, yes, sort of. We lived and worked on a cruise ship from June 2005 to December 2005 and let my brother live there while we were gone.

That's okay, the rule is that it must be the main place you lived for a total of 24 full months or 730 days during the five-year period prior to the sale. During the two years before you sold the house did you claim an exclusion on a gain from another house?

No, this is my only house.

Did you receive Form 1099-S?

No, but I do have my paperwork from the sale. My real estate broker said I wouldn't need that form because I was within the limits.

Your paperwork shows a selling price of \$580,000. Do you have anything that lists the basis in the home, that is, the value of the home at the time you bought it?

Yes, I bought it for \$280,000 and put in \$20,000 of improvements—mostly new bathrooms.

Clearly, with a basis of \$300,000, your gain from the sale is \$280,000 or less. As a married couple who meets the ownership and use tests, you can exclude up to \$500,000 from the sale, so you don't have to report the sale on your return.

[On page 2 of the approved intake and interview sheet, indicate Jeremy's responses to these questions.]



## What is the Five-year Test Period Suspension?

Taxpayers can choose to have the five-year test period for ownership and use suspended during any period the homeowner (either spouse if married) served on “qualified official extended duty” as a member of the Armed Forces. This means that the taxpayer may be able to meet the two-year use test even if the taxpayer and/or spouse did not actually live in the home during the normal five-year period required of other taxpayers.

Taxpayers are on qualified official extended duty if they serve at a duty station at least 50 miles from their main home or live in government quarters under government order. Taxpayers are considered to be on extended duty when they are called to active duty for more than 90 days or an indefinite period.



The HEART Act signed into law recently includes intelligence service employees and Peace Corps volunteers in this test period suspension when on qualified official extended duty.

### example

Peter bought a home in 1999 and lived in it for 2½ years. Beginning in 2002, he was on qualified official extended duty in the U.S. Army. He sold his home in 2008 and had a \$12,000 gain. Peter would normally not meet the use test in the five-year period before the sale (2003 – 2008). Peter can disregard those six years. The test period consists of the five years before he went on qualified official extended duty.

## Period of Suspension

The period of suspension cannot last more than ten years. Together, the ten-year suspension period and the five-year test period can be as long as fifteen years. The suspension can be used on only one property at a time.



This extension of time can apply to taxpayers who have recently left the military.



### EXERCISES (continued)

**Question 6:** John purchased a home in 1998. Through your interview process, you discover that he sold his main home in 2008. John had not lived in the home for six years. Which of the following conditions would allow John to exclude his gain?

- A. John went on sabbatical for four years and backpacked through Europe.
- B. John lived with a co-worker for four years and let his brother occupy his home.
- C. John was deployed to Europe on official extended military duty for five years.
- D. John married and his bride had her own home. The couple chose to live in the wife's home and rent out John's home, until it was sold.

## Summary

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This lesson covered how to report the sale of stock and the taxable portion of a sale of a residence.

This lesson also covered how to determine if a taxpayer must use Schedule D to report capital gains and losses on the sale of assets, and how to assist those taxpayers. You learned how to identify the asset's holding period, adjusted basis, net short-term and long-term capital gains or losses, the taxable gain or deductible loss, the tax liability, and the amount of capital loss carryover.

Short-term gains and losses are reported in Part I of Schedule D, and long-term gains and losses are reported in Part II. Part III summarizes the information of Parts I and II and determines the amount of the taxpayer's net taxable gain or deductible loss.

Schedule D requires information from Forms 1099-B, 1099-DIV, or 1099 Consolidated Statement and from taxpayer records (i.e. - the basis of the stock sold and the purchase date). Form 1099-B information reported on Schedule D includes date of sale, sales price, and description of property sold; it also indicates whether the gross or net proceeds were reported to the IRS.

To figure any capital loss carryover from 2007 to 2008, use the Capital Loss Carryover Worksheet from the 2008 Schedule D instructions. To complete the worksheet, you will need information from the 2007 return.

If TaxWise was used to prepare the 2007 return, ask the taxpayer for a copy of the TaxWise Schedule D Worksheet 2 (Capital Loss Carryovers from This Year to Next Year) to determine the carryover amounts for 2008.

You learned how to determine if taxpayers must report the sale of a home on their tax return. Individual taxpayers may exclude up to \$250,000 in gain and those Married Filing Jointly may exclude up to \$500,000.

To be eligible for the exclusion, taxpayers must:

- Have sold the home that has been their main home
- Meet the ownership and use tests
- Not have excluded gain in the two years before the current sale of the home

A "main home" is the place the taxpayer lived most of the time. The ownership and use tests require that, during the five-year period ending on the date of the sale, the taxpayers:

- Owned the home for at least two years (the ownership test), and
- Lived in the home as their main home for at least two years (the Use test)

The required two years of ownership/use do not have to be continuous.

Military and Intelligence Service personnel and Peace Corps volunteers that are deployed may be able to suspend the 5-year period for the use test.

The worksheets in Publication 523 help you figure the taxable gain from the sale of a home using selling price, amount realized, basis and adjusted basis, along with the maximum allowed exclusion.





## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Advanced - Dalhart
2. Military - Sierra
3. International - Holmes

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons in the advanced part of the training. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.



## EXERCISE ANSWERS

**Answer 1:** A. Only Marriah sold stock and received Form 1099-B.

**Answer 2:** A. You never adjust the sales price. If box 2 shows gross proceeds, you need to add the broker's fee to the basis or purchase price of the stock.

**Answer 3:** B. The sales price was \$4,400, which was \$1,900 more than the adjusted basis of \$2,500 (\$2,400 cost + \$100 commission) of the shares.

**Answer 4:** Yes. Emily meets the ownership and use test because she owned and lived in the home for at least two years of the five-year period ending on the date of the sale.

**Answer 5:** The amount realized on Jan's sale is \$180,000 (selling price minus selling expenses).

**Answer 6:** C. The only circumstance that will allow the taxpayer to exclude the gain is if he can extend the five-year period due to official extended military duty.

[illegible]

## Form 1040, Lines 15-16



### Introduction

This lesson will help you identify and report the taxable portion of retirement income received by the taxpayer. To do this, you must understand the types of retirement income and the forms used to report them. You should also be able to recognize when taxpayers should adjust their withholding and determine which form to use.

This lesson does not cover social security benefits or tier 1 railroad retirement benefits (social security equivalent benefits); they are discussed in a separate lesson titled Social Security Benefits.

To determine if the taxpayer must report retirement income, use the interview techniques and tools discussed in the lesson, Screening and Interviewing. The approved intake and interview sheet lists Pension and IRA distributions in the Income section. Ask the taxpayer about income or distributions from sources such as pensions, annuities, retirement or profit-sharing plans, or IRAs. This income may be fully or partially taxable. See Publication 4012, Volunteer Resource Guide, for examples of income (Tab D) and directions for entering retirement income information into TaxWise (Tab 2).

See Publication 575, Pension and Annuity Income, Publication 590, Individual Retirement Arrangements (IRAs), Publication 915, Social Security and Equivalent Railroad Retirement Benefits, and Publication 939, General Rule for Pensions and Annuities, for additional information on the topics discussed in this lesson.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Calculate the taxable portion of different types of retirement income
- Determine how to report retirement income on the tax return
- Determine when an adjustment to withholding should be made

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 4491-W

#### **Optional:**

- ☐ Publication 575
- ☐ Publication 590
- ☐ Publication 915
- ☐ Publication 939
- ☐ Form 1040 Instructions
- ☐ Form 1099-R
- ☐ Form 5329
- ☐ Form 8606
- ☐ Form W-2
- ☐ Form W-4P
- ☐ Form W-4V
- ☐ Simplified Method Worksheet

## Where can I get information about a taxpayer's retirement income?

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### Ask the Taxpayer

The approved intake and interview sheet includes questions about any retirement income that may have been received. If the taxpayer had retirement income, you may need to ask additional questions to clarify the type of plan, whether the income was before-tax or after-tax dollars, etc. This is explained later in this lesson.

Retirement income can include social security benefits as well as any benefits from annuities, retirement or profit sharing plans, insurance contracts, IRAs, etc. (For information about social security benefits and tier 1 railroad retirement benefits, see the lesson titled Social Security Benefits.)

Be considerate when probing for the information you need to complete the return. When taxpayers cannot provide the required information (and have not retained the packet of "retirement papers" they received when they retired), suggest that they contact their former employer or annuity administrator. You may want to give taxpayers a written list of questions that need to be resolved.

### Form 1099-R Series

Retirement income can be reported on:

- Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- Form CSA 1099-R, Statement of Annuity Paid (civil service retirement payments), and
- Form RRB 1099-R, Annuities or Pensions by the Railroad Retirement Board

If Form 1099-R is for an IRA-type distribution, the checkbox in Box 7 will be marked. The information will be entered on Form 1040, line 15, or Form 1040A, line 11. If Form 1099-R is for pensions, annuities, or other types of retirement income, the checkbox in box 7 will not be marked. The information will be entered on Form 1040, line 16, or Form 1040A, line 12.

Examples of these forms can be found in Publication 4491-W. These forms indicate such information as the amount received, the taxable portion, and the taxpayer's cost (investment) in the plan. If the taxable amount is indicated, then Basic and Intermediate certified volunteers can complete the return. In general, if the taxable amount is not indicated, then those volunteers certified in Advanced, Military, International must calculate the taxable portion using the Simplified General Rule Worksheet.

### What if the taxable portion is already calculated?

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In many instances, the payer will compute the taxable portion of the distribution and report it in box 2a of Form 1099-R or in the Taxable Annuity box of Form CSA 1099-R. Taxpayers with Form RRB-1099-R should be helped by volunteers who are certified in the Advanced, Military, or International courses only, since the taxable portion is not shown on the form.



**TaxWise Hint:** Link from line 15a (IRA distributions) or from line 16a (pension/annuity distributions) to complete Form 1099-R. Follow the instructions in the Volunteer Resource Guide (Tab 2). TaxWise will display the amounts in the correct places on Form 1040.

If preparing a paper return, you should record the amounts as follows:

- The gross amount (Form 1099-R, box 1, or Form CSA 1099-R, Gross Annuity amount box) should be shown on Form 1040, line 15a, or on Form 1040A, line 11a
- The taxable amount (Form 1099-R, box 2a, or Form CSA 1099-R, Taxable Annuity box) should be shown on Form 1040, line 15b, or on Form 1040A, line 11b

Any amount on Form 1099-R, box 4, or Form CSA 1099-R, box 11, should be included in the Payments section of the return.



### What if the taxable portion is not calculated?

If the payer did not include an amount in box 2a of Form 1099-R, or in the Taxable Annuity box of Form CSA 1099-R, or if the taxpayer has Form RRB 1099-R, you may need to interview the taxpayer further in order to compute the taxable portion of the distribution. The following discussion will help you determine the additional information that is needed to calculate the taxable portion of distributions from IRAs or pensions/annuities.



**TaxWise Hint:** TaxWise includes all the forms and worksheets you need in order to calculate the taxable portion of retirement income. These include Form 1099-R, the Exclusion Worksheet, and the Simplified General Rule Worksheet. The worksheets are found following Form 1099-R input document.

If you are preparing a paper return, use the Simplified Method Worksheet in Form 1040 and 1040A Instructions to calculate the taxable amount.

### What do I need to know about retirement income distributions?

Retirement plans are funded by either before-tax or after-tax contributions. “Before-tax” simply means that the employee did not pay taxes on the money at the time it was contributed, i.e. the taxpayer has no cost basis in the plan. “After-tax” means the employee has paid taxes on the money when it was contributed, i.e. the taxpayer has a cost basis in the plan.

If the taxpayer made contributions to a plan with before-tax dollars, then the entire distribution will be fully taxable. The funds are taxed at the time of the distribution because neither the contributions nor the earnings/investment gains have been previously taxed. This is common in 401(k) and Thrift Savings plans.



If the taxpayer does *not* contribute to the retirement plan, then all the distributions are fully taxable.

If the taxpayer made contributions to a plan with after-tax dollars, then the distribution will be partially taxable. The portion of the distribution that is considered a return of the “after-tax” dollars will not be taxed again. It is considered a return of the taxpayer’s cost basis (an amount for which taxes have already been paid). The portion of the distribution that represents the earnings/investment gains is taxable since it has not been previously taxed. This is common in employer retirement plans.

Employee Contributions	Contributions		Taxability of Contributions	
	Before-Tax	After-Tax	Fully	Partially
No	n/a	n/a	Yes	—
Yes	Yes	—	Yes	—
Yes	—	Yes	—	Yes

#### example

Mark retired in 2008 after working 30 years for a construction company. Each week, he contributed to the Carpenter’s Pension Plan. Every year, Mark paid tax on the gross amount of his salary, including his pension contribution. That means that his pension contributions were made with dollars that had already been taxed. Now that he is receiving payments from the pension, the portion that represents his contribution will not be taxed; the portion that represents earnings will be taxed.



Taxpayers may not always understand why they must pay taxes on their retirement income. When this is the case, take the time to clearly explain what retirement funds are taxed and why. It is usually a good idea to question taxpayers about the nature of their contributions to ensure that they will not be taxed twice on the same funds.

## How do I find the taxable portion of IRA income?

### Individual Retirement Arrangements

IRA distributions are reported on Form 1099-R with a check in box 7. Earnings and investment gains in a taxpayer’s IRA generally accumulate tax free until they are withdrawn as fully- or partially-taxable distributions. There are four kinds of IRAs, each with different tax implications:

- Traditional IRA
- Roth IRA
- Savings Incentive Match Plans for Employees (SIMPLE) IRA
- Simplified Employee Pension (SEP) IRA

#### **Traditional IRA**

Distributions from traditional IRAs are fully taxable unless nondeductible contributions have been made. See the Adjustments lesson for additional information.

Form 8606 is used to keep track of nondeductible contributions. Taxpayers who made nondeductible contributions should be referred to a professional tax preparer.



When you learn about IRA accounts in the Adjustments to Income lesson, be sure to note the difference between “contributions” and “deductions.” Simply put, contributions are the amounts deposited to an IRA account, and deductions are the portion of the contribution that is deducted on the tax return; that portion may be total or partial.

### example

Richard contributed \$500 a year to a traditional IRA. Each year he deducted these contributions from his income. This year he received his first distribution from the traditional IRA. It is fully taxable: Richard will pay income tax on the distributions he receives, which represent the contributions he made and deducted, as well as the earnings on these contributions over the years.

### **Roth IRA**

Distributions from a Roth IRA are tax free and may be excluded from income if the following requirements are met:

- The distribution is made after the 5-year period beginning with the first taxable year for which a contribution was made to a Roth IRA set up for the taxpayer's benefit, *and*
- The distribution is:
  - Made on or after age 59 1/2, or
  - Made because the taxpayer was disabled, or
  - Made to a beneficiary or to an estate, or
  - To pay certain qualified first-time homebuyer amounts (up to a \$10,000 lifetime limit)

If the above requirements are not met, the Roth IRA distributions could be partially taxable. If this is the case, refer the taxpayer to a professional tax preparer.

#### **TIP**

Taxpayers are considered disabled if they cannot engage in any substantial gainful employment because of a physical or mental condition. A physician must determine that the condition can be expected to result in death or to be of long, continued, and indefinite duration.



The next two topics are out of scope for VITA. The definitions are informational only.

### **Savings Incentive Match Plans for Employees (SIMPLE) IRA**

Some employers offer their employees (including self-employed individuals) the chance to contribute part of their pay to an IRA as part of a SIMPLE plan. The employer is also generally required to make contributions on behalf of eligible employees. Generally, SIMPLE IRA contributions are not included in an employee's income when paid into an IRA and the distributions are fully taxable when the employee receives them in later years.

### **Simplified Employee Pension (SEP) IRA**

Some employers offer their employees (including self-employed individuals) the chance to contribute part of their pay to an IRA as part of a SEP plan. Generally, SEP IRA contributions are not included in an employee's income when paid into the IRA. Because of this, distributions are generally fully taxable when the employee receives them in later years.





## EXERCISES

Answers follow the lesson summary.

**Question 1:** Distributions from all IRAs discussed in this topic are fully taxable with the exception of the Roth IRA. ☐ True ☐ False

**Question 2:** Mary opened a Roth IRA 3 years ago. In 2008, she took the full amount of her Roth IRA as a distribution to help her purchase her first home. The entire distribution is excluded from her taxable income. ☐ True ☐ False

**Question 3:** Amy contributed to a Roth IRA for 5 years. In year 6 (at age 60), she took a distribution from her IRA. The entire distribution is excluded from her taxable income. ☐ True ☐ False

## How are IRA distributions reported?

### *Traditional IRA*

Since the checkbox in box 7 on Form 1099-R reads SEP/SIMPLE/IRA, ask the taxpayer:

- Was this a distribution from a traditional IRA?
- Were the contributions deducted from income in the year they were made?

If so, the entire distribution is taxable. Report it on Form 1040, lines 15a and 15b, or on Form 1040A, lines 11a and 11b. If not, then the distribution is partially taxable. The taxpayer should be referred to a professional tax preparer.



Distributions from a SIMPLE IRA and from a SEP IRA are generally fully taxable and are out of scope for VITA.

### *Roth IRA*

Distributions from a Roth IRA are not taxable as long as they meet all the criteria discussed previously. If the distribution does not meet this criteria, then all or part of the funds will be taxable. Refer the taxpayer to a professional tax preparer.



**TaxWise Hint:** Link from Form 1040, line 15a. Enter the information from the taxpayer's Form 1099-R on the screen copy. TaxWise will display the amounts in the proper places on Form 1040.

If preparing a paper return for a fully taxable IRA-type distribution, record the amount on Form 1040, line 15b, or on Form 1040A, line 11b. It is not necessary to record an amount on line 15a or 11a since it is the same amount.

## How are rollovers handled?

Generally, a rollover is a distribution to the taxpayer from one retirement account (traditional IRA or employer's pension plan) that rolls over into a similar retirement account within 60 days.

Form 1099-R will be issued to the taxpayer by the financial institution. If it was a direct rollover by the institution to another institution, box 7 will contain code G. If there is no code G, then the taxpayer must have redeposited the full amount into an appropriate account within 60 days. If this was not done, the distribution may be partially taxable; refer the taxpayer to a professional tax preparer.



**TaxWise Hint:** Enter the information from the taxpayer's Form 1099-R. If this is a rollover, complete line 1 of the Exclusion Worksheet indicating the amount that was rolled over within the 60-day period. TaxWise will transfer the amount to the proper lines on Form 1040. In addition, you will need to check the box on line 15b and link (F9) to explain the facts of the rollover: from which financial institution, to which financial institution, and if it was a direct rollover.

If you are preparing a paper return, the amount of the distribution is reported on Form 1040, line 15a, or on Form 1040A, line 11a. To show that this is a qualified rollover and none of the amount is taxable, enter zero on Form 1040, line 15b, or on Form 1040A, line 11b.

## How do I find the taxable portion of pensions and annuities?

### Fully Taxable Pensions and Annuities

Pension and annuity income is reported on Form 1099-R (box 7 is unchecked), Form CSA 1099-R, and Form RRB 1099-R. In general, pension or annuity payments are fully taxable, if the following is true:

- Taxpayers did not pay any part of the cost of their pensions or annuities
- Employers did not withhold part of the cost from the taxpayers' pay while they worked
- Employers withheld part of the cost from the taxpayer's "before tax" pay while they worked



Social security benefits and IRA distributions are not reported on the pension line of the tax return.

#### example

Sue worked for a software development company for 20 years. She retired in 2008 and began receiving pension income the same year. Sue never contributed to the pension plan while she was working; her employer made all of the contributions. Her pension is fully taxable.

### Partially Taxable Pensions and Annuities

There are two methods used to figure the taxable portion of each pension or annuity payment: the General Rule and the Simplified Method. Unless an exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan. If a taxpayer tells you that they have been using the General Rule to figure the taxable portion for past years, refer them to a professional tax preparer.

The Simplified Method is used to calculate the tax-free portion of each pension or annuity payment. The Simplified Method Worksheet calculates the taxpayer's cost basis for each monthly payment. The number of monthly payments is based on the taxpayer's age (and the spouse's age if a joint/survivor annuity is selected by the taxpayer) on the annuity start date.

Taxpayer's cost basis ÷ Number of monthly payments = Monthly Tax-Free Portion



**TaxWise Hint:** The Volunteer Resource Guide (Tab 2) contains hints to help with this entry. Link (F9) from Form 1040, line 16, to Form 1099-R. Input the information from the taxpayer's copy on the screen. Move down the screen to the Simplified General Rule worksheet and complete items 1, 2, 4, and 5. Item 2 asks for the annuity starting date which may be earlier than the current tax year. Item 5 is an accumulation of tax-free amounts from previous years. This information should be available on the taxpayer's prior year return.

If preparing a paper return, use the Simplified Method Worksheet found in Form 1040A/1040 Instructions to calculate the taxable portion to be reported on line 16b/12b of the return. Question 2 asks for the cost in the plan which is found in box 9b of Form 1099-R. When choosing the proper response for Question 3, be sure to use the taxpayer's age (and the spouse's age if joint/survivor annuity is selected) at the time the annuity began. Question 4 is an accumulation of tax-free amounts from previous years. This information should be available on the taxpayer's prior year return. If the taxpayer has more than one Form 1099-R that is not fully taxable, calculate the tax-free portion for each one separately. Do not forget to include any amounts in box 4 of Form 1099-R in the Payments section of the tax return.

#### example

Melvin retired from a manufacturing plant in 2008. While he was working at the plant, his employer withheld money from each paycheck and sent it to the Engineer's Pension Fund. Melvin will receive a monthly pension payment for the rest of his life. Melvin will use the Simplified Method Worksheet to determine the tax-free part of monthly payments.



#### EXERCISES (continued)

**Question 4:** Dotty worked for the local tire plant for 32 years. She retired in June of 2008 and she receives a monthly pension of \$1,679. (She received six payments for July through December 2008.) Dotty never contributed to the pension plan. Her employer made all of the contributions. How much of her pension is taxable?

- A. \$12,074
- B. \$11,074
- C. \$10,074
- D. \$1,679

## Disability Pension Income

Generally, taxpayers who retire on disability must include all of their disability payments in income. Disability payments are taxed as wages until the taxpayer reaches the minimum retirement age (set by the employer). After the taxpayer reaches the minimum retirement age, disability payments are treated as pension income to determine its taxability.



If disability pay is treated as wages it may affect Earned Income Credit.

Minimum retirement age is generally the earliest age at which taxpayers may receive a pension whether or not they are disabled.

Employers may report disability income on one of the following forms:

- Form W-2, Wage and Tax Statement, if the taxpayer has not reached the minimum retirement age set by the employer
- Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. if the taxpayer has reached the minimum retirement age



**TaxWise Hint:** Link from line 7 (if the taxpayer's document is Form W-2) or from line 16 (if the taxpayer's document is Form 1099-R). Enter the information from the taxpayer's document into TaxWise. TaxWise will place the amounts on the appropriate lines on the Form 1040 screen.

If preparing a paper return, follow these instructions. Box 2a of Form 1099-R indicates the taxable amount of disability income reported by an employer. Check to see if box 7 Distribution Code(s) shows Code 3 (Disability). If box 7 indicates that the taxpayer is receiving disability payments, then determine if the taxpayer has reached the minimum retirement age (set by the employer).

If the taxpayer has not reached the minimum retirement age, report the disability income as wages on line 7 of Form 1040 or Form 1040A.

If the taxpayer has reached the minimum retirement age, report the disability income as a taxable pension. Follow these guidelines:

- If the disability payments are partially taxable, use Form 1040, lines 16a and 16b or Form 1040A, lines 12a and 12b
- If the payments are fully taxable, enter the taxable amount on line 16b or line 12b; do not make an entry on line 16a or line 12a



## EXERCISES (continued)

**Question 5:** Annie Jo is 47 years old and has retired on disability from her job. While loading cargo for a tractor-trailer company, a large box fell on her and left her paralyzed. She receives a monthly payment from her former employer's pension plan. She has not reached the minimum retirement age set by her company's pension plan. On which line of her Form 1040 should you report her disability income?

- A. Line 63
- B. Line 16a
- C. Line 16b
- D. Line 7

### What other retirement income issues are there?

Frequently, taxpayers who receive Form 1099-R with code 1 in box 7 are subject to the 10% additional tax for premature distributions because the money received has been spent for items that do not meet any of the exceptions. If you help taxpayers who meet one of the exceptions, refer them to a professional tax preparer. However, if there is no exception, you may prepare the return and enter the 10% additional tax on the return. TaxWise will do this automatically.

There are a few other issues related to reporting retirement income that you may encounter. Some of the following distributions are subject to various additional taxes that are computed on Form 5329, Additional Taxes on Qualified Plans and Other Favored Accounts. The completion of this form is not included in the VITA/TCE training. Refer taxpayers subject to these additional taxes to a professional tax preparer. The following information is provided for your awareness only.

### Lump-Sum Distributions

A lump-sum distribution is the distribution or payment within one tax year of an employee's entire balance from all qualified pension, stock bonus, or profit-sharing plans that the employer maintains. The distribution does not include deductible voluntary employee contributions and certain amounts forfeited or subject to forfeiture. Distributions from IRAs or tax-sheltered annuities do not qualify as lump-sum distributions.

To qualify as a lump-sum distribution, the payment must have been made:

- Because the plan participant died, or
- After the participant reached age 59 1/2, or
- Because the participant (not including a self-employed individual) separated from service with the employer, or
- After the participant, if a self-employed individual, becomes totally and permanently disabled

Lump-sum distributions are reported on Form 1099-R like any other pension distribution. Some lump-sum distributions qualify for special tax treatments. If Form 1099-R, box 7 indicates a distribution code of A, it is a lump-sum distribution and qualifies for special tax treatments. Taxpayers with this situation should be referred to a tax professional.



## EXERCISES (continued)

**Question 6:** Andrew received Form 1099-R from his previous employer in 2008. \$11,200 is shown in box 1, and the letter A is shown in box 7. Andrew deposited the entire \$11,200 into his IRA within 30 days of receiving the check (rollover).

Which of the following statements is true?

- A. The entire distribution is includible as income
- B. The entire distribution is excludible from income
- C. The distribution is eligible for the ten-year tax option
- D. The distribution is eligible to be taxed at a special rate

### Premature Distributions

A premature distribution is an early withdrawal from a retirement fund, for purposes other than retirement, by a taxpayer who is under 59 1/2. Early distributions are subject to an additional 10% tax. The tax applies to the taxable portion of the distribution or payment.

Certain early distributions are excluded from the early distribution tax. If the distribution code in box 7 of Form 1099-R is 2, 3, or 4, the taxpayer does not have to pay the additional tax.

If the distribution code in box 7 is 1, Form 5329 needs to be completed to determine if the taxpayer meets one of the exceptions and does not have to pay the additional tax. If the taxpayer wishes to get relief from the additional tax, refer them to a professional tax preparer. For more information on exceptions to the age 59 1/2 rule, see the chapter on Traditional IRAs in Publication 590.

### Minimum Distributions

To avoid an additional tax, participants in retirement plans must begin taking a minimum required distribution (MRD) by a previously specified date. That date is April 1 of the calendar year following the year in which the taxpayers either reached age 70 1/2, or retired, whichever is later. For IRAs, it does not matter if the taxpayer is employed. These rules do not apply to Roth IRAs. The trustee of the qualified plan will contact the taxpayer at the appropriate time to begin MRD.

#### example

Ralph retired in 2002. He turned 70 1/2 in 2008. He must begin taking minimum distributions from his qualified plans by April 1, 2009.

#### example

Myrna was 72 when she retired in 2008. She must begin taking minimum distributions from her qualified plans by April 1, 2009.

### example

Irving was still employed when he turned 72 on March 12, 2008. His qualified plan is an IRA, so he was required to begin taking minimum distributions after age 70 1/2 even though he was not yet retired. He turned 70 1/2 on September 12, 2006 and began taking minimum distributions before April 1, 2007.

After the starting year for MRD distributions, taxpayers must receive the minimum distribution for each year by December 31 of that year. (The starting year is the year in which the taxpayer reaches 70 1/2 or retires.) If no distribution is received during the taxpayer's starting year, the minimum required distributions for two years must be received the following year.

This information is provided for information purposes only to help you answer any questions that the taxpayer may ask about MRD. MRD distributions are reported on the Form 1099-R and included on the return using the procedures previously discussed.



If the taxpayer does not receive the minimum distribution, an additional tax may be imposed. The tax is 50% of the difference between the minimum distribution and the amount actually distributed for the tax year.

### Withdrawal of Excess IRA Contributions

An excess IRA contribution is the amount contributed to a traditional IRA during the year that is more than the smaller of:

- \$5,000 (\$6,000 if age 50 or older), or
- The taxable compensation for the year

The taxpayer may not know that a contribution is excess until the tax return is completed after the end of the year. When this situation is identified the excess amount, with any earnings on that amount, need to be withdrawn by the due date of the return including extensions. If the excess amount is not withdrawn by the due date of the return, the taxpayer will be subject to an additional 6% tax on this amount.

The withdrawn excess contribution is not included in the taxpayer's gross income if both of the following conditions are met:

- No deduction was allowed for the excess contribution
- All interest or other income earned on the excess contribution is withdrawn

However, taxpayers must include the earnings on the excess contribution as income on the return. This income is reported on the return for the year in which the withdrawal was made.



### EXERCISES (continued)

**Question 7:** Taxpayers who withdraw excess contributions by the end of the tax year are not subject to an additional 6% tax on the excess contribution.

☐ True   ☐ False





## EXERCISES (continued)

**Question 8:** Helen turned 71 on March 17, 2008. She retired in 2001. She has never taken any distribution from her traditional IRA accounts. The bank where she has her IRA told her that she now needs to take a minimum distribution of \$1,479 per year. Helen should:

- A. Take a distribution of \$1,479 by December 31, 2008
- B. Take a distribution of at least \$1,479 by April 1, 2008 and at least another \$1,479 by December 31, 2008
- C. Take a distribution of \$2,958 by December 31, 2008
- D. Not take any distributions until 2009

### How do I determine when an adjustment to withholding should be made?

After the completion of the return, if the taxpayer owes \$1,000 or more on the tax return, you should discuss their withholding and estimated tax options with them. This is covered in more detail in the Concluding the Interview lesson.

Sometimes taxpayers are not aware that they can request federal income tax to be withheld from their retirement income by filing Form W-4P, Withholding Certificate for Pension and Annuity Payments. This form is sent to the payer. Also, Form W-4V, Voluntary Withholding Request, is used to request withholding from social security benefits. This form is sent to the Social Security Administration.

#### TIP

Taxpayers who receive a very large refund may make better use of their funds if the withholding is lowered. Explain ways they can reduce their withholding.

A taxpayer who chooses not to have tax withheld may have to pay estimated tax each quarter. Failure to have enough federal income tax paid throughout the year can result in a large amount of tax being owed when the return is due. It can also result in a penalty. Form 1040ES, Estimated Tax for Individuals, is used to calculate the estimated quarterly payment and provides vouchers with which to remit the payments.



## EXERCISES (continued)

**Question 9:** Faith comes to your site to get her 2008 tax return done. When you finish her return, you explain to her that she owes \$985, and that she needs to pay this amount by April 15, 2009. She says that she will pay the amount, but wants to know if there is some way to have more tax withheld from her pension so that she doesn't owe so much at the end of the year. Which form should she complete to increase the withholding from her pension?

- A. Form W-4P
- B. Form W-4V

## Summary

This lesson helped you identify, calculate, and report the taxable portion of retirement income received by the taxpayer. It reviewed the types of retirement income and the forms used to report them. You learned when taxpayers of retirement age are required to take a minimum distribution from a retirement plan and when they may need to adjust their withholding.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Intermediate - Yale
2. Advanced - Dalhart
3. Military - Sierra
4. International - Holmes

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons in the intermediate and advanced parts of the training. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.



### EXERCISE ANSWERS

**Answer 1:** *False. In addition to Roth IRAs, nondeductible contributions to traditional IRAs are also not taxed when they are distributed.*

**Answer 2:** *False. Mary's distribution was not made after the 5-year period beginning with the first taxable year she made a contribution to her Roth IRA. Therefore, the earnings/investment gains portion of the distribution will be taxable income. (She may also owe an early distribution penalty on the taxable portion. This will be discussed in Lesson 17.)*

**Answer 3:** *True. Amy's distribution can be excluded from her taxable income because it was made six years after her first contribution and it was made on or after age 59½. There is not sufficient information given to determine that her blindness qualifies her as being "disabled" for purposes of excluding the distribution.*

**Answer 4:** *C. Dotty's entire pension amount of \$10,074 (6 x \$1,679) is fully taxable because she has never paid income taxes on her employer's contribution to her pension.*

**Answer 5:** *D. Because Annie Jo has not reached the minimum retirement age set by her employer, you should report her disability income as wages on line 7 of her Form 1040.*



**Answer 9:** A. Generally, Form W-4P, Withholding Certificate for Pension and Annuity Payments, is used to request a change in withholding on a pension.

[illegible]

[illegible]



### Introduction

This lesson will help you identify and report rental income and expenses for U.S. citizens and resident aliens. To do this, you need to know how to allocate rental income and expenses when property is also used for personal purposes. You must also be able to identify when the at-risk and passive activity rules are applicable and compute deductible depreciation expenses.

The at-risk and passive activity issues in this lesson are beyond the usual scope of volunteer training, with the exception of assisting military and other government employees living abroad and with limited access to both resources and professional preparers.

To determine if a taxpayer needs to file Schedule E, use the interview techniques and tools discussed in the Screening and Interviewing lesson. The approved intake and interview sheet does not list income from rent, but it is important to ensure that all income is accurately reported on the return. Ask taxpayers if they rented out their home or other property during the tax year.



This lesson does not apply to taxpayers who are in the actual business of renting properties.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine which types of rental income must be reported
- Identify how to report rental expenses

### What is rental income?

Renting a room or a home to a tenant is an income-producing activity. U.S. citizens and resident aliens must report rental income, regardless of whether the rental property is located in the U.S. or in a foreign country. Gross rental income may include other payments in addition to the normal and ordinary rents received, such as:

- Advanced rent
- Security deposits
- Payments for breaking a lease

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Publication 527
- ☐ Schedule A
- ☐ Schedule E

#### Optional:

- ☐ Publication 925
- ☐ Publication 946
- ☐ Form 8582



The security deposit is not included in income when the taxpayer plans on returning the deposit at the end of the lease. However, if the security deposit is intended to serve as the last month's rent, then it should be included in income when received.

- Expenses paid by the tenant
- Fair market value of property or services received in exchange for rental payments

The taxpayer's method of accounting affects when the rental income is reported. The cash method reports income when received and expenses when paid; the accrual method reports income when earned and expenses when incurred. Most individuals use the cash basis method.



It is important that property be rented at fair rental value. If a property is rented at less than fair rental value, the income and expenses are reported in a different manner than discussed in this lesson. Refer taxpayers who rent their property at less than fair rental value to a professional tax preparer.

## What qualifies as a rental expense?

Homeowners who reside in homes they own generally report mortgage interest and property taxes as itemized deductions on Schedule A. However, when a taxpayer rents out a home, those become rental expenses along with the cost of repairs, maintenance, and certain other operating expenses.

## What about mortgage interest and property taxes?

Mortgage interest and property taxes are deductible as rental expenses. If the residence (or a portion of the residence) was used as rental property for any part of the year, the taxpayer must allocate the property tax and mortgage interest deductions between Schedule A and Schedule E.

In general, taxpayers use Schedule A, Itemized Deductions, to report the portion of the mortgage interest and property taxes that apply to their use of the home. That portion can be based on a percentage of time (4 months as a residence and 8 months used as rental) or based on an area (1,500 sq. ft. as a residence and 500 sq. ft. as the rental portion). For the part of the year and/or the portion of the home that is rented out, taxpayers report rental income and expenses (including a portion of the mortgage interest, property taxes, and other expenses that relate to the rental time/portion of the home, etc.) on Schedule E, Supplemental Income and Loss.

If any part of the property tax is designated for local benefits that increase the value of the property, such as maintaining streets and sidewalks, that portion of the tax is added to the basis of the property rather than as an ordinary rental expense or an itemized deduction.

Mortgage interest is reported to the taxpayer on Form 1098, Mortgage Interest Statement. This statement may also include property taxes. If it does not, the taxpayer will have a document from the local taxing authority.



Generally, mortgage interest expense is fully deductible. However, refer taxpayers with rental-related interest expenses other than mortgage interest to a professional tax preparer.

### example

Paul Kingman lived in his home through September, when he was notified he was being transferred overseas. He rented his home beginning in October. The total amount of Kingman's mortgage interest for the tax year was \$2,400 and his property taxes were \$600. Report nine months (Jan – Sept) of mortgage interest and property taxes as itemized deductions on Schedule A, i.e. \$1,800 and \$450, and the other three months (Oct-Dec) as expenses on Schedule E, i.e. \$600 and \$150.



## EXERCISES

**Question 1:** John Princeton was transferred overseas and began renting out his residence on September 1 of the tax year. How much of his mortgage interest and property taxes should be reported on his Schedule E?

- A. All of it
- B. Eight-twelfths (2/3 or 67%)
- C. Four-twelfths (1/3 or 33%)
- D. None of it

### What about property insurance?

The property insurance taxpayers pay on their residence is deductible as a rental expense for the time it is considered rental property. If the residence is rented for part of the year, only the amount that covers the rental time is deductible. If a portion of the residence is rented, the deductible portion must be allocated and deducted on Schedule E.

Insurance premiums paid more than one year in advance cannot be deducted in one year. All taxpayers must prorate advanced premium payments over the period covered by the policy. The only portion deductible in the current year is that amount which covers the current year.

### What are other deductible rental expenses?

In addition to mortgage interest and property taxes, deductible rental property expenses include these items listed on Schedule E:

- Advertising
- Auto and travel expenses to check on the property
- Cleaning and maintenance
- Commissions paid for collecting rental income
- Insurance premiums
- Property taxes
- Mortgage interest and points
- Legal and professional fees
- Property management fees
- Repairs
- Utilities paid for the tenant
- Other rental-related expenses, such as rental of equipment and long distance phone calls, condominium/cooperative maintenance fees, etc.

#### TIP

When a tenant does not pay the rent, a cash-basis landlord cannot take a deduction for the unpaid rent. Taxpayers cannot take a deduction for a payment they did not include in income.



## Can auto and travel expenses be deducted as rental expenses?

Taxpayers can deduct ordinary and necessary travel and transportation expenses attributable to the production of rental income. If the travel was into or outside of the U.S., the taxpayer should substantiate the pleasure vs. business portions of the trip and allocate the expenses accordingly.

Taxpayers who use their personal automobile for rental-related trips may use either the standard mileage rate or the actual expense method for business mileage.

The standard mileage method multiplies the miles driven for business by a standard cost. Taxpayers may use the standard mileage rate only if they meet one of these requirements:

- The vehicle was owned and used the standard method the first year the vehicle was put into service
- The vehicle was leased and used the standard method for the life of the lease

The actual expense method figures the deduction based on a variety of factors, including gasoline, oil, repairs, insurance, rentals, and may even involve depreciation or the value of a vehicle provided by the taxpayer's employer.

### TIP

This lesson discusses only the standard mileage rate. If the taxpayer wishes to use the actual method, refer them to a professional tax preparer.

### 2008 Mileage Rates

Purpose	Cents per Mile 1/1/08 - 6/30/08	Cents per Mile 7/1/08 - 12/31/08
Business	50.5	58.5

## Are repairs and improvements deductible?

Taxpayers often misunderstand when an expense qualifies as a repair or an improvement. A repair keeps the property in good operating condition; the cost is a current-year deduction. An improvement adds to the life or material value of the property, or adapts it to new uses; the cost must be depreciated over the recovery period for the improvement. The total cost of an improvement includes material, labor, and installation.

### TIP

Additional information on rental income can be found in Publication 527, Residential Rental Property, and Publication 946, How to Depreciate Property.

Repairs (Deduction)	Improvements (Depreciation)
Painting	Adding a room
Fixing gutters	Installing a new fence
Repairing driveways	Putting in plumbing or wiring
Replacing window glass	Replacing hot water tank
Repairing the roof	Putting on a new roof
Repairing appliances	Replacing/adding major appliances



## EXERCISES (continued)

**Question 2:** All of the following are examples of deductible rental expenses *except*:

- A. Carpet cleaning fees
- B. Charges for phone calls made to the property manager
- C. Gas and electric bills paid for the tenant
- D. Repairs made to the homeowner's personal residence

**Question 3:** Which of the following rental expenses must be recovered by taking depreciation?

- A. Home insurance premiums
- B. Painting
- C. Installing a backyard fence
- D. Repairing a broken furnace

### How do I handle depreciation of rental property?

The cost of property with a useful life of one year or more, and used in a trade or business or held for the production of income (such as rent), is recovered by deducting an expense called depreciation.

"Depreciable property" includes buildings, machinery, furniture, equipment, vehicles, and any cost for additions or improvements to rental property. The value of land, however, is not depreciable: therefore, the cost of clearing, grading, planting, or other land improvements are also not depreciable.

The annual amount of depreciation on property reduces the taxpayer's basis in that property. Taxpayers should claim the correct amount of depreciation every year. Even if they did not deduct the depreciation during any tax year, they must still reduce their basis in the property by the amount of depreciation that they should have deducted.

### What factors affect depreciation?

The factors that affect the depreciation amount are:

- Depreciation method
- Basis of the property
- Recovery period for the property

#### ***Depreciation Method***

The most common methods for determining depreciation are:

- Property placed in service before 1981: Straight line or declining balance
- Property placed in service after 1980 but before 1987: ACRS (Accelerated Cost Recovery System), and

- Property placed in service after 1986: MACRS (Modified Accelerated Cost Recovery System)

This training focuses on the MACRS method.



## EXERCISES (continued)

**Question 4:** Taxpayers have the option of not claiming a depreciation deduction they are entitled to and avoid reducing the basis in their depreciable property.

☐ True ☐ False

**Question 5:** All of the following property may be depreciable EXCEPT \_\_\_\_.

- A. Furniture
- B. Buildings
- C. Land
- D. Vehicles

**Question 6:** Which method of depreciation is used for property placed in service after 1986?

- A. Straight line
- B. MACRS
- C. ACRS
- D. Declining balance

### ***What is considered the basis and adjusted basis for depreciation purposes?***

Generally, the basis for depreciation is the purchase price of the property, including the cost of improvements, but not including the value of the land on which it sits. When property is converted from personal use to rental use, the basis is the lesser of the adjusted basis or fair market value (FMV) at the time of conversion. The total of the yearly deductions for depreciation can never total more than the basis of the property.



For taxpayers who built their own home or acquired it as an inheritance or gift, the basis may not be the original cost. For more information, see Publication 551, Basis of Assets.

### **example**

Carlos and Vanetta purchased a house in 1985 for \$100,000. The value of the building was \$85,000. They made no improvements. In 2007, they were transferred overseas and decided to rent out the home, which was their personal residence. The value of the house and land in 2007 was \$125,000. The basis for depreciation is \$85,000.

The basis of property must be increased or decreased to reflect certain adjustments before the depreciation deduction is computed. To find the adjusted basis, add the purchase price of a home to the cost of any improvements minus:

- Any casualty losses or depreciation previously deducted, and
- Land value

The basis of depreciable property should also be adjusted when it is acquired in a purchase with a trade-in. Again, the value of any associated land must be assessed and excluded from the basis of the property.

### What are considered recovery periods?

The recovery period of property is the number of years over which the taxpayer recovers its cost or other basis. The MACRS method uses the class life of property to determine the length of time the property will be depreciated.

#### example

A set of major appliances that Mark Newcomb used in his rental property had an adjusted basis of \$500. He acquired a set of new appliances with a fair market value of \$2,000 by trading in the old appliances and paying \$1,000 in cash. Although the fair market value of the new appliances was \$2,000, Mark's basis for depreciation purposes is \$1,500 (the \$500 adjusted basis plus his \$1,000 cash payment).



#### EXERCISES (continued)

**Question 7:** The purchase price of Wayne's rental property, including land, was \$255,000, when the value of the land was assessed at \$155,000. He spent \$50,000 on improvements to the building, and another \$10,000 on landscaping. What is Wayne's basis for depreciation in the property?

- A. \$305,000
- B. \$255,000
- C. \$160,000
- D. \$150,000

### How do I figure the MACRS deduction?

To figure the MACRS deduction, you need to know the property's:

- Placed in service date
- Recovery period
- Depreciable basis

### What is the placed in service date?

For depreciation purposes, property is considered placed in service when it is in a condition or state of readiness and availability for use. A property's depreciation deduction is prorated in the year it is placed in service. However, a depreciation deduction may not be claimed until the property is actually used either in business or for the production of income.

## What are considered recovery periods under MACRS?

The recovery period of the property depends on the class the property is in. Each item of depreciable property is assigned to a property class. Property classes are based on the property's class life and determine its recovery period. Under General Depreciation System (GDS), the recovery period of an asset is generally the same as its property class. A table is available in Publication 527, Residential Rental Property, to help determine the correct recovery period for an item.

Under MACRS:

- A home converted in 1986, or later, to a rental property would be depreciated over a recovery period of 27.5 years
- A stove used in this same rental would be assigned a 7-year recovery period



See Publication 946, How to Depreciate Property, Appendix A for Tables of Depreciation, which show the recovery periods for different property classes.

Property located outside the U.S. has a longer recovery period than property in the U.S., and the taxpayer must use the Alternative Depreciation System (ADS) under MACRS. ADS generally increases the number of years over which the property is depreciated and therefore decreases the annual deduction. Residential rental property located in a foreign country is depreciated over a 40-year recovery period.



### EXERCISES (continued)

**Question 8:** Which of the following properties would generally have the shortest recovery period for depreciation? (Use the table in Publication 527.)

- A. A rental home located in the U.S.
- B. A washing machine in a rental unit located in the U.S.
- C. Improvements to a rental unit located outside the U.S.
- D. A rental home located outside the U.S.

## Taxpayer Example

As you use the approved intake and interview sheet with a taxpayer, ask questions to determine if they have any rental income and expenses. Use the Interview Tips to help obtain additional information, as shown in this sample interview.

## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*I see you've been stationed overseas last year from March through December. Did you rent out your home during that time?*

*We only need to deal with last year. Now, during January of last year you were the only one living in the house?*

*For January, we'll report a twelfth of your mortgage interest and property taxes as itemized deductions on Schedule A. For February through December, we'll report your mortgage interest, most property taxes, the cost of maintenance and repairs, and other expenses on Schedule E.*

*Now, how much did you receive in rent and other payments from February through December?*

*I have Form 1098 for your mortgage interest and the invoice for your property taxes. I'll need the amount of your homeowners insurance for the year. Did you have any other expenses related to renting, such as repairs or improvements?*

*We'll report the paint job on Schedule E as an expense. We'll also work out the depreciation on both the house and the refrigerator.*

### TONY RESPONDS...

Yes. From February 1 through the end of the year. Actually, the tenant was there for thirteen months—he just moved out.

Yes, that's right. How does all that affect my taxes?

O.K.

There was rent of \$1,200 each month, and the last month's cleaning deposit.

Yes, just before I left the country, I spent \$1,000 having the place painted and I installed a new refrigerator.

## How do I handle rental property that the taxpayer also uses?

When the rental property is a portion of the taxpayer's residence, the rental income and expenses must be allocated separately from the taxpayer's personal expenses.

### How do I differentiate between rental expenses and personal use expenses?

Expenses that apply to only the rental part of a property are business expenses and should be reported in full on Schedule E. The cost of installing a second phone line strictly for a tenant's use, for example, is deductible as a rental expense. However, the taxpayer cannot deduct any part of the cost of the *first* phone in a partially-rented property, even if tenants use it.

Expenses that benefit the entire property must be divided between rental use and personal use; the rental portion is reported on Schedule E. If deductions are itemized, the personal portion of home mortgage interest and property tax may be reported on Schedule A. The taxpayer can choose any reasonable method to allocate the expenses. The most common methods are based on the number of rooms in the dwelling or on the total area of the dwelling.

On Schedule E, report expenses that apply exclusively to the rental room and the allowed percentage of expenses that benefit the entire house. For example, if the rented portion is 10% of the property:

- 100% of the cost to wallpaper the tenant's room
- 10% of property taxes, utilities, mortgage interest, and depreciation

#### example

Gloria rents one room in her house to a tenant. The total square footage of her house is 1,200 square feet. The rental room measures 10 feet by 12 feet (120 square feet, or 10% of the total house). She may deduct:

- 100% of any expenses that relate only to the rental portion of the house, such as repairs or upgrades to the rented room
- 10% of any qualified expense that benefits the entire house

When taxpayers can itemize personal deductions on Schedule A, they can report the deductible expenses that benefit the entire house minus the percentage that applies to the tenant's room. In Gloria's case, if she is treating the rental portion as 10% of the residence, she can deduct the following on Schedule A:

- 90% of the mortgage interest
- 90% of the property taxes



#### EXERCISES (continued)

**Question 9:** For taxpayers who rent part of a property in which they live, what expenses are reported only on Schedule E and not on Schedule A?

- A. Home insurance and mortgage interest
- B. Property taxes and repairs
- C. Utilities and home insurance
- D. Depreciation and property taxes

### How should taxpayers report rental expenses that exceed their rental income when they live in the home?

The way taxpayers report rental expenses depends on how much they use the property. How taxpayers report rental expenses that exceed their rental income depends on how much they use the property.

Taxpayers who do not use the rental home as their residence should:

- Include the rent as income, and
- Deduct all the rental expenses, even if expenses exceed income

Taxpayers who rent out their residence 15 days or more during the year should:

- Include the rent as income, and
- Deduct the rental expenses up to the rental income; expenses that exceed rental income may not be deductible

Taxpayers who rent out their residence fewer than 15 days during the year may *not* include the rent as income or deduct rental expenses.



### ***Are there any limitations?***

Deductibility limitations apply to rental expenses for a dwelling the taxpayer uses as a home more than the greater of:

- 14 days, or
- 10% of the number of days during the tax year the property is rented at fair market value

#### **TIP**

A residence or dwelling unit might be a house, apartment, condominium, mobile home, boat, or similar property. The limitations do not apply to hotels, motels, inns, or similar dwelling units.

#### **example**

Latricia converted the basement of her home into a one-bedroom apartment. She rented the apartment out at a fair rental price to college students during the nine-month school year. During June, Latricia's brother stayed in the apartment rent-free. (This is considered personal use.) Limitations apply to Latricia's rental expense deductions because the apartment was used for personal purposes for 30 days, which was more than the greater of:

- 14 days, or
- 10% of the 270 days it was rented (27 days)

### ***Are there any exceptions?***

Taxpayers who used a dwelling unit as their main home may not have to count all that time as "days of personal use" if, for 12 or more consecutive months, they rented or tried to rent the dwelling unit at a fair rental price. In this case, days of personal use do not include the time the taxpayer used the property as his or her main home before or after renting it or offering it for rent.

This exception applies for the purposes of determining whether to limit the deductibility of rental expenses. It does not apply when dividing expenses between rental and personal use.

Any day the taxpayer spent working substantially full time repairing and maintaining the rental property is not counted as a day of personal use, even if the taxpayer's family members used the property for recreation purposes on the same day.

#### **example**

On February 28, 2005, Trent moved out of the house he had lived in for six years because he accepted a job in another town. He rented his house at a fair rental price from March 15, 2005, to May 14, 2007. On June 1, 2007, he moved back to town and moved back into his house. Because he rented his property for 12 or more consecutive months, his use of the house is not counted as personal use. Since these days are not counted as days of personal use, the limitations on deductions do not apply.



## EXERCISES (continued)

**Question 10:** Which of the following taxpayers cannot deduct any of their rental expenses?

- A. Julio, who rented out his house eight months last year. After the tenants moved out, he let his sister and brother-in-law stay in the house two months rent-free.
- B. Marcel, who rented a room of his condo all year and lived there himself 11 months.
- C. Cherice, who offered a room for rent in her home all year, but had only one renter who stayed just one month.
- D. Lois, who rented her home 12 days, then allowed her father to live there rent-free the rest of the year while she worked overseas.



**TaxWise Hint:** From Form 1040, line 17, link to Schedule E, page 1.

- If the property was used as a rental for the entire year, the income and expenses can be recorded on Schedule E
- If the property was used partially as a rental and partially as a residence, some expenses may need to be allocated

To allow TaxWise to help with this calculation, use the Part Year, Rental, Ownership Worksheet. From Schedule E, page 1, box 1A, link to the Rental A Worksheet. Input all income and expenses on this document. Use the checkbox to allocate the personal portion of mortgage interest and property taxes to Schedule A. Complete the percent box to allocate amounts between personal and deductible rental expenses. Record expenses in the proper column: *rental and personal use* (mortgage interest, property taxes, property insurance, etc.) or *rental only* (management fees, repairs, advertising, etc.)

When preparing a paper return, record income and expenses on Schedule E. If an allocation is necessary, do all computations before entering deductible amounts in the expense section.

## How do I handle rental losses?

Deducting all rental expenses and depreciation from the rent received may result in a net loss. Rental losses are not always fully deductible. There are two restrictions on how much a loss can offset other sources of income:

- At-risk rule
- Passive activity law

### What is the At-risk Rule?

The at-risk rule places a limitation on the amount the taxpayer can deduct as losses from activities often described as tax shelters. Generally, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount the taxpayer has at risk in the activity at the end of the tax year.

## What is the Passive Activity Law?

The passive activity law states that passive activity losses can be deducted only from passive activity income. Passive income does not include salary, dividends, or investments, but is generally attributed to such things as rental income. Therefore, losses that exceed rental income (the passive activity) are not deductible.

### **Passive vs. Active**

The limits on deducting rental losses are affected by the degree to which renting out the property is a passive activity or involves active participation:

- Passive rental activity means receiving income mainly from the use of property rather than for services.
- Active participation means making significant management decisions, such as approving rental terms, repairs, expenditures, and new tenants. Taxpayers who use a leasing agent or property manager could be considered active participants if they retain final management rights.

### **Exception**

Rental activities are generally considered passive activities. For this reason, rental losses are not fully deductible. However, an exception to the passive activity rule provides that taxpayers who actively participate in the rental activity can use up to \$25,000 of their rental losses to offset any other nonpassive income (\$12,500 for married taxpayers filing separately and living apart for the entire year). Examples of nonpassive income are salaries, wages, commissions, tips, self-employment income, interest, dividends, annuities, and some royalties.

## What is active participation?

It is considered active participation when taxpayers own at least 10% of the rental property and make management decisions in a significant and bona fide sense. Management decisions include approving new tenants, deciding on rental terms, approving expenditure, and similar decisions.

### **TIP**

For more information, see Publication 925, Passive Activity and At-Risk Rules.

### **example**

Sally Jenkins, a U.S. citizen, lives in Europe and is paid \$25,000 in wages by the U.S. Government, and \$100 of interest income. She rented out her U.S. home and incurred \$1,000 in rental loss for the tax year. Although her sister collects the rent, Sally makes all of the decisions as to whom, and for what amount, the property will be rented. While Sally is in Europe, she pays her sister to manage the property. Sally's rental loss of \$1,000 may be offset against her gross income of \$25,100 because she is considered to be an active participant in the rental activity.

### **Phase-Out of Offset**

The amount allowed to offset nonpassive income is:

- Reduced once the taxpayer's adjusted gross income (AGI) exceeds \$100,000 (\$50,000 for married filing separately)
- Completely phased out when AGI exceeds \$150,000 (\$75,000 for married filing separately)

Refer taxpayers with an AGI over \$100,000 to the IRS or a professional tax preparer.



## EXERCISES (continued)

**Question 11:** Which restriction limits the deductibility of rental loss to the amount of rental income?

- A. Phase-Out of Offset
- B. Passive activity law
- C. Active participation rule

### How are passive rental losses reported?

Taxpayers use Form 8582 to figure the amount of any passive activity loss allowed for the current tax year. Form 8582 summarizes losses and income from all passive activities.

Generally, taxpayers are not required to file Form 8582 if they have:

- Only one passive loss generated from a rental activity, and
- An adjusted gross income (AGI) of less than \$100,000



**TaxWise Hint:** TaxWise will automatically generate and complete Form 8582 if required. If any questions arise regarding whether to file or how to complete Form 8582, refer the taxpayer to the IRS or a professional tax preparer.



## EXERCISES (continued)

**Question 12:** Which taxpayer is most likely required to file Form 8582, Passive Activity Loss Limitations?

- A. Chelsea, who owns two rental dwellings with no net loss and has an AGI of \$111,000
- B. Lance, who owns one rental dwelling with a loss of \$1,444, and has an AGI of \$34,000
- C. Sean, who owns one rental dwelling with a loss of \$800, and has an AGI of \$103,000

## Summary

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Rental income and deductible rental expenses are recorded on Part I of Schedule E, Supplemental Income and Loss. U.S. citizens and resident aliens must report rental income for the months their home is rented, regardless of whether the rental property is located in the U.S. or in a foreign country.

When renting out part of the property, certain expenses must be divided between rental use and personal use; some are reported on Schedule A and some on Schedule E.

Taxpayers who do not use a dwelling unit as a home (for personal purposes) should include all the rent in their income and deduct all the rental expenses. Those who rent out their homes:

- 15 days or more during the year may not be able to deduct rental expenses that exceed rental income
- Fewer than 15 days during the year should not report any of the income or deduct any of the rental expenses

Because rental activities are generally considered passive activities, rental losses are not fully deductible. However, taxpayers who actively participated in the renting of the property may deduct up to \$25,000 of their rental losses, up to \$12,500 for married taxpayers filing separately and living apart.

The passive activity law states that passive activity losses can be deducted only from passive activity income. Taxpayers with rental losses may be required to file Form 8582, Passive Activity Loss Limitations.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Military - Sierra
2. International - Holmes



## EXERCISE ANSWERS

**Answer 1:** C. You would deduct four-twelfths (33%) of his mortgage interest and taxes on Schedule E, and report the other 67% on Schedule A.

**Answer 2:** D. Repairs made to the homeowner's personal residence are not deductible as rental expenses. However, the other expenses are deductible, along with repairs made to rental property, legal and professional fees, and property management fees.

**Answer 3:** C. Fencing adds to the value of the property, so the cost cannot be deducted as a rental expense. Instead, it must be depreciated over the useful life of the improvement.

**Answer 4:** False. Taxpayers should claim the correct amount of depreciation every year. If they don't, they still must reduce their basis in the property by the amount of depreciation that they could have deducted.

**Answer 5:** C. The value of land is not depreciable; furniture and vehicles are depreciable property.

**Answer 6:** B. MACRS (modified ACRS) is the method used for property placed in service after 1986.

**Answer 7:** D. Wayne's basis for depreciation is \$150,000 (\$255,000 minus \$155,000 plus \$50,000). The basis does not include landscaping expenses.

**Answer 8:** B. The recovery period of an appliance, based on its class life, is shorter than that of a home, and property located inside the U.S. has a shorter recovery period than property outside the U.S.

**Answer 9:** C. The rental portion of utilities, home insurance, repairs, and depreciation are rental deductions on Schedule E, but the personal portion are not reported on Schedule A. Taxpayers who rent out part of a property allocate mortgage interest and property taxes separately on both schedules.

**Answer 10:** D. Lois rented her home out fewer than 15 days during the year and used it for personal purposes by allowing her father to live there rent-free.

**Answer 11:** B. Passive activity losses can be deducted only from passive activity income. Taxpayers who are not active participants may not deduct rental losses that exceed rental income.

**Answer 12:** C. If Sean had an AGI of less than \$100,000, he wouldn't have to file Form 8582 because he had only one passive rental loss.

## Form 1040, Line 19



### Introduction

This lesson will help you assist taxpayers who have unemployment compensation payments.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify unemployment compensation income
- Determine how to report unemployment compensation on the tax return

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ **Optional:** Form 1099-G

### What is unemployment compensation?

Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or of a state. In most cases, it is taxable.

### Where can I get unemployment compensation information?

Begin with the unemployment question on the approved intake and interview sheet. Ask the taxpayer for any Form(s) 1099-G, Certain Government Payments that document unemployment compensation payments from each government entity.

In most states, a taxpayer can elect to have federal income taxes withheld from their unemployment compensation benefits. Be sure to review box 4 of Form 1099-G for any federal income tax withheld.

### How do I report unemployment compensation?

The total for all amounts in box 1 of Form(s) 1099-G should be entered on:

- Line 3 of Form 1040EZ
- Line 13 of Form 1040A
- Line 19 of Form 1040



If completing a paper return, the amounts from Form 1099-G, box 1 should be entered on Form:

- 1040, line 19
- 1040A, line 13 or
- 1040EZ, line 3

The amount from Form 1099-G, box 4 should be entered on Form:

- 1040, line 62
- 1040A, line 38 or
- 1040EZ, line 7



**TaxWise Hint:** From line 19, link (F9) to complete the Unemployment Benefits Received Worksheet. Enter any unemployment compensation amounts from Form 1099-G, box 1 and the withholding amounts from Form 1099-G, box 4. TaxWise automatically displays the total unemployment income on line 19 and includes the withholding on line 63 of Form 1040.

## Practice – Vanessa Franklin

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-16 to determine if Vanessa has to report any unemployment compensation.

## Summary

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This lesson explained:

- How to identify unemployment compensation
- How to report unemployment compensation



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes

### Form 1040, Line 20a



### Introduction

This lesson will help you assist taxpayers who have social security and railroad retirement benefits.

To properly report income, use the interview techniques and tools discussed in the Screening and Interviewing lesson. The approved intake and interview sheet lists Social Security and Railroad Retirement Benefits in Item 11 of the Income section.

Ask the taxpayer about the receipt of either of these benefits. The Social Security Administration issues Form SSA-1099, Social Security Benefit Statement, to social security benefit recipients. The Railroad Retirement Board uses Form RRB-1099, (Tier 1-Social Security equivalent benefits), or RRB-1099-R, Annuities or Pensions by the Railroad Retirement Board. These benefits may or may not be taxable.

See Publications 575, Pension and Annuity Income, and 915, Social Security and Equivalent Railroad Retirement Benefits, for additional information on the topics discussed in this lesson.

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- The taxable portion of social security and railroad retirement benefits
- How to report social security and railroad retirement benefits on the tax return

### What Are Social Security and Railroad Retirement Benefits?

#### Social Security Benefits

Social security benefits are payments made under Title II of the Social Security Act. They include OASDI (old-age, survivors, disability insurance), and some workers' compensation benefits.

If the taxpayer received social security benefits plus other income, some portion of the social security benefit may be taxable. Generally, if social security benefits are the only source of income, then the benefits are not taxable. In this instance the taxpayer may not be required to file a return.

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W

#### **Optional:**

- ☐ Publication 575
- ☐ Publication 915
- ☐ Form RRB-1099
- ☐ Form RRB-1099-R
- ☐ Form SSA-1099
- ☐ Social Security Benefits Worksheet

## Railroad Retirement Benefits (RRBs)

Railroad Retirement Benefits (RRBs) are benefits paid to railroad employees working in jobs that are covered by the Railroad Retirement Act (RRA). The RRA benefits have two components: tier 1 (social security equivalent benefits) and tier 2 (pension plan benefits treatment). The Tier 2 benefits are reported on Form RRB 1099-R. These funds are discussed in the previous lesson on Retirement Income.

### How are these benefits reported to the taxpayer?

#### **Form SSA-1099**

Social security benefits are reported to the taxpayer on Form SSA-1099. To correctly calculate the taxable portion, you need to know the amount in box 5 (Net Benefits). Taxpayers who did not receive Form SSA-1099, or have misplaced it, can get a printout of benefits from their local social security office or request a replacement by accessing social security's web site at [www.ssa.gov](http://www.ssa.gov). The income is reported on Form 1040, line 20a and b, and on Form 1040A, line 14a and b. See Publication 4012, Volunteer Resource Guide (Tab 2) for specific information on how the data on Form SSA-1099 is input into TaxWise.

#### **Form RRB-1099**

Railroad retirement benefits are reported on Form RRB-1099 and Form RRB-1099R (Tier 1). These benefits fall into two categories that are treated differently for income tax purposes. See Publication 4012, Volunteer Resource Guide (Tab 2) for specific information on how the data on Form RRB-1099 is input into TaxWise. Tier 1 RRBs are equal to the social security benefit that a railroad employee or beneficiary would have been entitled to receive under the social security system. These benefits are called "social security equivalent benefits" and for tax purposes are treated like social security benefits. They are shown on the BLUE part of Form RRB-1099. Box 5 shows the net social security equivalent benefits for Tier 1.

#### **example**

Jacob is a retired railroad switchyard operator. Using the approved intake and interview sheet, the volunteer determined Jacob received Railroad Retirement Benefits. He received Form RRB-1099 and Form RRB-1099R. The amount from Form RRB-1099 will be added to any amount of Social Security benefits.

### How do I find the taxable portion of social security benefits and tier 1 RRBs?

The taxable amount, if any, of a taxpayer's social security benefits depends upon filing status and other reportable income. Part of the following benefits received by the taxpayer may be taxable:

- Social security benefits
- Railroad retirement benefits, tier 1 (social security equivalent portion)

Generally, if social security benefits were the taxpayer's only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return. If the taxpayer received social security benefits and other income, complete the Social Security Benefits Worksheet to calculate the taxable portion. This worksheet is included in Form 1040 Instructions or can be found on [www.irs.gov](http://www.irs.gov).

Some of the benefits received are taxable if total income, plus one-half of the benefits received, is more than certain base income amounts, which vary based upon the taxpayer's filing status.

If the taxpayer files a joint return, combine the income and benefits of both spouses when completing the worksheet. Even if the spouse received no social security benefits, include the spouse's other income when completing the worksheet. If both spouses received benefits, combine both their benefits and income when completing the worksheet for the return.



The taxable portion of social security benefits is never more than 85% of the net benefits the taxpayer has received. In many cases, the taxable portion is less than 50%.

#### example

Wanda and Dan are both retired and will file a joint return. Wanda received Form SSA-1099 with an amount of \$4,300 appearing in box 5. Dan retired from the railroad, and box 5 of his Form RRB-1099 shows an amount of \$6,800. Wanda and Dan will use the combined benefits of \$11,100 and only one worksheet to calculate if any of their benefits are taxable.

## How do I report Social Security or Railroad Tier 1 benefits?



**TaxWise Hint:** The Volunteer Resource Guide (Tab 2) offers specific information on entering each amount from SSA Form 1099 and Form RRB-1099 into TaxWise. From Form 1040, line 20a, link to Form 1040 Worksheet 1. Be sure to record the Social Security (Form SSA-1099, box 5) and Railroad Tier 1 (Form RRB-1099, box 5) benefits on the proper lines and in the proper columns (if a joint return). Include any amounts paid for Medicare (Form SSA-1099, Description box and Form RRB-1099, box 11) for potential itemized deductions. Medicare premiums include Part B and Part D. Include any amounts for federal income tax withholding (Form SSA-1099, box 6 and Form RRB-1099, box 10). TaxWise will perform all the calculations to determine the taxable amount based on other information in the return.

If you are preparing a paper return, report taxable social security benefits by following these steps:

1. Complete the other income and adjustment items on page 1 of Form 1040 or Form 1040A.
2. Complete the Social Security Benefits Worksheet in the 1040 or 1040a Instructions to calculate if any of the benefits are taxable.
3. If you determine that any benefits are taxable:
  - On Form 1040, enter the social security benefits received on line 20a, and enter the taxable portion (from line 18 of the worksheet) on line 20b
  - On Form 1040A, enter the benefits received on line 14a, and enter the taxable portion of benefits on line 14b

4. If you determine that no benefits are taxable, report the full benefits on Form 1040, line 20a, or on Form 1040A, line 14a. Report "0" on form 1040, line 20b or on Form 1040A, 14b.
5. If the taxpayer is itemizing deductions, include the Medicare premiums (Part B and D) from Form SSA-1099, Description box, and from Form RRB-1099, box 11, on Schedule A.
6. To give the taxpayer credit for any federal income tax withholding, record any amount shown in Form SSA-1099, box 6, and Form RRB-1099, box 10, on Form 1040, line 62, or Form 1040A, line 38.



For those taxpayers with income over the threshold (line 8 of the Social Security Benefits Worksheet), complete the rest of the worksheet to calculate the taxable benefit amount portion on lines 10 to 18.



## EXERCISES

Answers follow the lesson summary.

**Question 1:** Hank comes to your site to get some help with his tax return. He is upset because his neighbor told him that he would have to pay tax on all of his social security benefits this year. After talking to Hank, you learn that his wife died in 2007. In 2008, he sold his farm and moved into senior housing. The sale of the farm created \$31,896 of taxable income for Hank. His neighbor told him, with that much income, the entire \$11,724 of his social security benefits would be taxable. What is the maximum taxable amount of Hank's benefits?

- A. \$31,896
- B. \$20,172
- C. \$11,724
- D. \$9,965

## What are Lump-Sum Benefit Payments?

Some taxpayers may have received a lump-sum benefit payment in 2008. This payment could be for both the current tax year and the prior tax year. Box 3 of the taxpayer's Form SSA-1099 or Form RRB-1099 will include the lump-sum payment. The form will also show the year, or years, of the payment. The additional information will be shown in Description of Amount in box 3 on Form SSA-1099 or in boxes 7-9 on Form RRB-1099.

When figuring the taxable portion of social security benefits, two options are available for lump-sum benefit payments:

- The **first option** allows the taxpayer to report the whole payment in 2008, the year it was received. When the taxpayer chooses this option, complete the Social Security Benefits Worksheet as usual by including the entire lump-sum payment on line 1.
- The **second option** is to treat the payment as received in the earlier year or years. This is done by figuring whether any part of these benefits is taxable, based on the earlier year's income. Any part that is taxable is then added to any taxable benefits for the current year (2008) and included on Form 1040, line 20b.

If the taxpayer chooses to spread the payments back to earlier years, only 2008 income will be adjusted. The taxpayer does not file amended returns for the earlier years. However, a special procedure must be used to figure the taxable portion of the benefits assigned to the earlier years. If taxpayers want to use this option, refer them to a professional tax preparer or to Publication 915.



## EXERCISES (continued)

**Question 2:** Joan presents you with her Form SSA-1099, which includes a lump-sum benefit payment for both 2007 and 2008. For which option would you refer her to a professional tax preparer?

- A. Averaging the benefit over the number of years
- B. A special procedure used to figure the taxable portion of the benefits assigned to the earlier years
- C. Reporting the whole payment in 2008
- D. Reporting half the payment in 2007 and the other half in 2008

## Summary

This lesson explained how to determine whether income from taxpayers' social security benefits and railroad retirement benefits may be taxable.

Generally, if social security benefits were the taxpayer's only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return. If the taxpayer received social security benefits and other income, the Social Security Benefits Worksheet needs to be completed to calculate the taxable portion.

When figuring the taxable portion of social security benefits, two options are available for lump-sum benefit payments. The taxpayer may report the whole payment in the year it was received or treat the payment as received in the earlier year or years. Taxpayers who want to use the latter option should be referred to a professional tax preparer and/or Publication 915.



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

- 1. Intermediate - Yale
- 2. Advanced - Dalhart
- 3. Military - Sierra
- 4. International - Holmes

If you are unable to complete the entire exercise, complete as much of it as you can. Come back later to finish the exercise after you covered all the technical topics in later lessons.



**Answer 2: B.** There are two options available for figuring the taxable portion of social security benefits paid as lump-sum benefit payments. The first option allows the taxpayer to report the whole payment in the year it was received. The other option is a special procedure that must be used to figure the taxable portion of the benefits assigned to the earlier years. Refer taxpayers who want to use this option to a professional tax preparer or to Publication 915.

## This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



## Form 1040, Lines 21-22



### Introduction

This lesson will help you determine other forms of income and how to report other sources of income.

This lesson will also help you report income earned from worldwide sources. To do this, you need to be able to identify the type of income and, if reportable, convert it to the equivalent U.S. dollar value of the foreign currency. This requires using the contemporaneous exchange rate or, if not known, an average annual exchange rate.

This lesson will help you determine who is eligible for the foreign earned income exclusion and how to calculate the excludable amount by using Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- Other types of income and how to report other sources of income
- How to properly report income earned from worldwide sources
- Who is eligible for the foreign income exclusion and how to calculate the excludable amount using Form 2555, Foreign Earned Income or Form 2555-EZ, Foreign Earned Income Exclusion

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 54
- ☐ Publication 4491-W
- ☐ Form 1040 Instructions
- ☐ Form 2555
- ☐ Form 2555-EZ
- ☐ **Optional:** Publication 525

### How do I handle other income?

“Other income” is anything that does not have its own line on Form 1040. Here are examples:

- Prizes and awards
- Gambling winnings, including lotteries and raffles
- Jury duty fees
- Alaska Permanent Fund dividends



Total gambling winnings must be reported on line 21 of Form 1040. If the taxpayer also had gambling losses, the losses can only be deducted on Schedule A. (See the Itemized Deductions lesson for more information.)

If you are unsure about sources of other income, consult the Volunteer Resource Guide, Tab D, and Publication 17, Part II, or discuss the income item with your site coordinator.

To ensure that all taxable income has been included, use the interview techniques and tools discussed in the Screening and Interviewing lesson.

## How do I report other income?

In most cases, if a taxpayer has “other income” they must file Form 1040 and report the income on line 21.



**TaxWise Hint:** To report each source of “other income,” enter the type under line 21 and then link to the appropriate form, worksheet, or scratchpad. TaxWise adds up the other income amounts and displays the total on line 21.



## What is worldwide income?

U.S. citizens and U.S. resident aliens are required to report worldwide income on a U.S. tax return regardless of where they live and even if the income is taxed by the country in which it was earned. Filing requirements are the same as for U.S. citizens and U.S. resident aliens living in the United States and apply whether income is from within or outside the U.S.

U.S. citizens and U.S. resident aliens living abroad may be able to claim tax benefits such as the foreign earned income exclusion and the foreign tax credit.

### example

In 2008, Alfredo Kendall earned \$40,000 while working in Dallas, Texas, for Dade Corporation. In September 2008, he transferred to their office in Stuttgart, Germany. While in Germany, he earned \$30,000 (U.S. dollars). All of Alfredo's wages, including the income he earned in Germany, is included in his gross income; enter \$70,000 on line 7 of his Form 1040.

Income is treated the same on the return regardless of the country from which it is derived. Similar income earned inside or outside the U.S. is generally taxed in the same way on the return. Likewise, income earned in the U.S. and not taxed will be treated in the same way if earned outside the U.S. The lines on which income is reported on Form 1040 are the same whether the U.S. citizen or U.S. resident alien is living within or outside U.S. boundaries.



Foreign income might be reported to the taxpayer on forms or in ways that are not used in the United States. Question the taxpayer closely to ensure that the taxpayer is reporting all worldwide income. Review the income records to ensure that includible amounts are accurate and complete.



## EXERCISES

Answers are listed following the lesson summary.

**Question 1:** Marta Bremer, a U.S. citizen, lives in Mussbach, Germany. Her 2008 income included \$22,000 in wages earned in Germany. She earned \$300 in interest from her U.S. bank and \$2,000 unemployment compensation from the state of Iowa. What is Marta's total income?

- A. \$2,300
- B. \$22,300
- C. \$24,000
- D. \$24,300

**Question 2:** Mary Carleton, a U.S. citizen, lives in Belgium. Her 2008 income included \$10,000 in wages from her Belgian employer, \$200 in interest from her U.S. bank, \$8,000 in alimony payments, and \$7,000 in child support payments from her ex-spouse. What is Mary's total income?

- A. \$8,000
- B. \$10,200
- C. \$18,200
- D. \$25,200

## How do I convert foreign income to U.S. dollars?

### Exchange Rates

All amounts on the U.S. tax return must be stated in U.S. dollars. Convert income taxpayers received in foreign currency into U.S. dollars using the appropriate exchange rate. U.S. exchange rates are stated in two ways:

- Units of foreign currency to one U.S. dollar: 0.74855 Euro = 1 U.S. dollar
- U.S. dollars to one unit of the foreign currency: 1.33592 U.S. dollar = 1 Euro

To convert a sum of money into U.S. dollars, **divide** the amount of foreign currency by the exchange rate for the foreign currency to one U.S. dollar.

#### example

Ryan received 3,000 Euros (€3000) on a day that the exchange rate was 0.74855 Euros to one U.S. dollar. Based on this exchange rate, the value of Ryan's €3000 is:  $€3000 \div 0.74855 = \$4,007.75$

In other words:

Amount of foreign currency  
 Exchange rate of foreign currency to one U.S. dollar = Amount in U.S. dollars

3,000 Euros  
 0.74855 = \$4,000.75



## EXERCISES (continued)

**Question 3:** Caryn received 200 Euros on a day that the exchange rate was .75514 Euros to one U.S. dollar. In U.S. dollars, she would have \_\_\_\_.

- A. \$264.85
- B. \$377.57
- C. \$115.03
- D. \$11.50

**Question 4:** Given an exchange rate of .7000, how much is 36,000 Euros worth in U.S. dollars?

- A. \$252.00
- B. \$25,200.00
- C. \$51,428.57
- D. \$61,614.00

### Which exchange rate should I use?

The exchange rate for a particular currency is likely to change every day, so the exchange rate is determined by the date of transaction. The date of transaction is either the date on the check or the date the money is credited to the taxpayer's account.

However, the taxpayer can use the average annual exchange rate if:

- They have received foreign income evenly throughout the year, and
- The foreign exchange rate was relatively stable during the year

Taxpayers may use the monthly average exchange rates if they earned foreign income evenly for one or more months, but less than twelve months.

#### example

Edward Hall worked in Dallas for Lubbock Incorporated from January until September 2008. On September 29, he was transferred to Lubbock's Mexico City office, where he will be working for three more years. In Mexico, he is paid in Mexican pesos. Because he received the majority of his 2008 salary in U.S. currency, he should not use the annual average exchange rate for the Mexico source income. If he does not know the exchange rate at the time he received the funds, he can use the monthly average exchange rate for October, November, and December.

### Where to Obtain Exchange Rates

In mid-January, the IRS distributes exchange rates for various currencies to its world-wide offices, including the prior year's average annual exchange rate information.

To obtain exchange rates, call the IRS International office at 215-516-2000 (not toll-free) or the overseas IRS offices. The phone numbers of these offices are listed in Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad. Exchange rates can also be found at [www.irs.gov](http://www.irs.gov) by typing "foreign currency rates" in the search box. You may also contact banks that provide international currency exchange services.

Because taxpayers should use the rate that most nearly reflects the value of the foreign currency at the time they receive the income, taxpayers may use an exchange rate that is different from the rates posted in IRS worldwide offices if they find it to be a true representation.



**TaxWise Hint:** Refer to the Volunteer Resource Guide, under the TaxWise tab titled 'Income,' and find the page titled How/Where to Enter Income.

Link from line 7 to Form FEC-Foreign Employer Compensation.

If the taxpayer qualifies to claim the Foreign Earned Income Exclusion, Form 2555 or Form 2555-EZ can be filed electronically.

Enter the taxpayer's address at the time the money was earned. For Section e, TaxWise Help can be used to determine the appropriate country code. Enter the foreign employer's information. List the compensation amount in U.S. dollars.

Once you enter the information, TaxWise automatically reports the total on line 7 of Form 1040.



## What is the foreign earned income exclusion?

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Certain taxpayers can exclude income earned in, and while living in, foreign countries. For 2008, the maximum exclusion amount is \$87,600. The foreign earned income exclusion does not apply to wages and salaries of U.S. military members and civilian employees of the U.S. Government.

For tax years beginning after 2005, nonexcluded income is taxed for both the regular tax and the AMT (Alternative Minimum Tax) at the rates that would apply if taxable income included the foreign earned income exclusion and foreign housing exclusion.

The Foreign Earned Income Tax Worksheet from the Form 1040 Instructions must be used to calculate the tax. TaxWise will do this automatically.

If the taxpayer qualifies to exclude foreign earned income, the excludable amount will be reported as a negative amount on Form 1040, line 21. Since the foreign earned income would have been reported on Form 1040, line 7 as taxable wages or on line 12 as self-employment income, the exclusion (negative amount) will reduce the total income calculated on line 22.

## When do I choose the exclusion?

The foreign earned income exclusion is voluntary. It is not always an advantage to claim the exclusion. If taxpayers wish to claim the exclusion, they must file either Form 2555-EZ or Form 2555 with a timely return (including extensions). If the taxpayer is not eligible for the foreign earned income exclusion, any taxes paid on this income to a foreign government may be eligible for the foreign tax credit. See the lesson Foreign Tax Credit for more information.

Once the taxpayer chooses to exclude foreign earned income, that choice remains in effect for that year and all later years until revoked. Taxpayers may revoke the exclusion for any tax year by attaching a statement. When the exclusion is revoked, the taxpayer may not claim the exclusion again for the next five tax years without the approval of the IRS.

## What are the eligibility requirements?

To claim the foreign earned income exclusion taxpayers must:

- Demonstrate that their tax home is in a foreign country
- Meet either the bona fide residence test or the physical presence test
- Have income that qualifies as foreign earned income

The requirements are applied separately to each individual. If a husband and wife are working overseas, each must meet all requirements to qualify for the exclusion. If they do qualify, each is entitled to an exclusion of up to \$87,600 (on qualified income) for 2008.

### TIP

The terms “foreign,” “abroad,” and “overseas” do not include Puerto Rico, U.S. Virgin Islands, American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, Wake Island, the Midway Islands, and Johnston Island.



## EXERCISES (continued)

**Question 5:** Miranda has lived in Puerto Rico since 2000. Is she eligible for the foreign earned income exclusion? ☐ Yes ☐ No

## How do I determine the tax home?

To claim the foreign earned income exclusion, the taxpayer's tax home must be in a foreign country. The tax home is defined as the country in which the taxpayer is permanently or indefinitely engaged to work as an employee or a self-employed individual, regardless of where the family home is maintained.

For taxpayers who work abroad but do not have a regular place of business because of the nature of the work, their tax home is the place where they regularly live. The tax home for members of the U.S. Armed Forces is the permanent duty station, either land- or ship-based. **Generally, most U.S. military members and their dependents do not qualify for the foreign earned income exclusion.**

### example

John and Mary are both in the armed forces and have been permanently stationed in Germany since August 2003. Their tax home for 2008 is Germany.



## EXERCISES (continued)

**Question 6:** Alan has lived and worked in China since August 16, 2001. For 2008, China is his tax home. ☐ True ☐ False

## What is a regular place of abode?

For purposes of the foreign earned income tax exclusion, if taxpayers work overseas for an indefinite period of time, and their regular place of abode is the U.S., the taxpayers cannot designate the foreign country as the tax home.

“Regular place of abode” is defined as one’s home, habitation, domicile, or place of dwelling. It does not necessarily include one’s principal place of business.

If the taxpayer maintains a place of business, or is assigned to overseas employment in a foreign country for an indefinite period, and *does not maintain a regular place of abode in the U.S.*, the tax home is overseas and the taxpayer may be eligible for the foreign earned income exclusion.

## How do I determine whether the U.S. is the taxpayer’s regular place of abode?

Ask three questions to determine whether a U.S. home is the taxpayer’s regular place of abode:

1. Did you use your home in the U. S. as a residence while you worked at your job in the U. S. just before going abroad to your new job, and did you continue to maintain work (contacts, job seeking, leave of absence, ongoing business, etc.) in that area in the U. S. during the time you worked abroad?
2. Are your living expenses duplicated at your U.S. and foreign homes because your work requires you to be away from your U.S. home?
3. Do you have a family member or members living at your U.S. home, or did you frequently use your U.S. home for lodging during the period you worked abroad?

If the answer to two of the questions is “no,” the taxpayer is considered to be indefinitely assigned to the new location abroad and is eligible for the foreign earned income exclusion.

If the answer to all three questions is “yes,” and the job duration is for less than one year with the taxpayer returning to the U.S. home, the taxpayer is considered “temporarily away” from home. In this case, the taxpayer does not qualify for the foreign earned income exclusion, but may qualify to deduct *away-from-home* expenses.

If the answer to two of the three questions is “yes,” with the same expectation of job duration and return to the U.S. home, the location of the tax home depends on the facts and circumstances.

### example

Henry is a member of the armed forces. He was assigned to a post in Japan in 2008. This assignment was for an indefinite period that exceeds one year. Margaret, his wife, accompanied him to Japan and has foreign earned income. They have not used their home in the U.S. as a place of residence for over a year. Therefore, their tax home for 2008 is Japan.





## EXERCISES (continued)

**Question 7:** Stan is employed on an off-shore oil rig in the territorial waters of a foreign country and works a 28-day on/28-day off schedule. He returns to his family residence in the U.S. during his off periods. Does Stan's employment satisfy the tax home test? ☐ Yes ☐ No

### What is the period of stay requirement?

The period of stay is the amount of time the taxpayer stays in the foreign country. To meet the period of stay requirement, the taxpayer must be either:

- A U.S. citizen or U.S. resident from a tax treaty country who is a **bona fide resident** of a foreign country (or countries) for an uninterrupted period that includes an entire tax year, or
- A U.S. citizen or U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months

### What is the bona fide residence test?

To meet the bona fide residence test, taxpayers must show that they have set up permanent quarters in a foreign country for an entire, uninterrupted tax year. Simply going to another country to work for a year or more is not enough to meet the bona fide residence test. A taxpayer must establish a residence in the foreign country.

A brief trip to the U.S. will not prevent the taxpayer from being a bona fide resident, as long as the intention to return to the foreign country is clear.

#### example

Charles is a military spouse who has lived and worked in England since 2002. His mother still lives in the U.S. Charles came to the U.S. for two weeks in 2008 to be with his mother after she had surgery. Charles' trip to the U.S. does not affect his status as a bona fide resident of a foreign country.



## EXERCISES (continued)

**Question 8:** Zach, a U.S. citizen, has homes in the U.S. and in Spain, where he has worked for the last two years. Zach's wife, who is also a U.S. citizen, lives with him in Spain. Zach visits the U.S. frequently. Does Zach meet the bona fide residence test in Spain? ☐ Yes ☐ No

### What is the physical presence test?

If the taxpayer does not meet the bona fide residence test then they may qualify under the physical presence test rules. To qualify, the taxpayer must be physically present in a foreign country 330 full days during a period of twelve consecutive months.

In order for a day to count for the test, it must be a full day in a foreign country. When arriving from the U.S., or returning to the U.S., any day in which part of the time is spent in the U.S. or over international waters does not count as a qualifying day in a foreign country.

The taxpayer may move about from one place to another in a foreign country or to another foreign country without losing full days. If any part of the taxpayer's travel is not in any foreign country and takes less than 24 hours, you are considered to be in a foreign country during that part of travel. See Publication 54, Physical Presence Test column for additional information.

#### example

If a taxpayer left England by ship at 10:00 p.m. on July 6 and arrived in Lisbon at 6:00 a.m. on July 8, the taxpayer would lose July 6, 7, and 8 as full days because the trip took more than 24 hours. In this example, if the taxpayer remained in Lisbon, the first full day would be July 9.

## Figuring the 12 Month Period

Any 12 month period may be used if the 330 full days in a foreign country fall within that period. If necessary, more than one period may be used, including periods that overlap. See Publication 54 for clarification on the physical presence rules.

## What is qualifying income?

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To qualify for the exclusion, income must be earned income.

### How does earned income qualify for the exclusion?

To qualify for the exclusion, the earned income must be for services performed in a foreign country. Amounts paid by the United States or its agencies to its employees *do not qualify* for the exclusion. This includes military pay and payment for such activities as post exchanges, commissaries, and officers clubs.

Earned income **does not include**:

- Dividends
- Interest
- Capital gains
- Alimony
- Social security benefits
- Pensions
- Annuities

#### example

Margaret, a U.S. resident, is a member of the armed forces and has lived in Japan since 2001. Her military pay is not eligible for the foreign earned income exclusion. In her spare time, she is a self-employed DJ in Tokyo. The income from her self-employment may qualify for the exclusion.

## What are sources of earned income?

To qualify for the exclusion, services must be performed in a foreign country. Where the payments come from or where they are deposited is not a factor in determining the *source* of the income.

If a taxpayer works predominantly in a foreign country, but does some work in the U.S., an adjustment must be made to the total foreign earned income.

### example

Earl works and lives in the Bahamas. In 2008, he worked 50 weeks in the Bahamas. He attended a business meeting in Florida for one week, and was on vacation for one week. One-fiftieth or 2% of his wages are not foreign earned income, because of the week spent working in Florida.



### EXERCISES (continued)

**Question 9:** Juanita lives in Scotland. She is retired and her income consists of U.S. social security, a pension, and several stock dividends. Does she qualify for the foreign earned income exclusion? ☐ Yes ☐ No

## When do I complete and file Form 2555 or Form 2555-EZ?

If the taxpayer qualifies to exclude foreign earned income, Form 2555 or Form 2555-EZ must be completed. Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad has an illustration of a tax return with Form 2555 completed for the husband and Form 2555-EZ completed for the wife.

To be able to use Form 2555-EZ, the taxpayer must:

- Be a U.S. citizen or resident alien who has wages and salaries, but not self-employment income
- Have total foreign earned income of \$87,600 or less
- Have no business or moving expense deductions

Taxpayers who do not meet these restrictions should file Form 2555 to claim the exclusion.

### example

Michael and his wife, Eva, have been stationed in Hong Kong since 2003. Michael is a member of the armed forces and Eva operates a home day care business. Their tax home is Hong Kong, and they meet the bona-fide residence test. Eva wants to exclude her self-employment income from U.S. taxation.

Because her income is from self-employment, she will need to complete Form 2555 instead of Form 2555-EZ to exclude the income, and must complete Schedule SE to pay social security and Medicare.



## EXERCISES (continued)

**Question 10:** Mallory is a U.S. citizen who has \$34,000 of foreign earned income. She has no other income. Which form should she file?

- A. Form 2555
- B. Form 2555-EZ

### How do I complete Form 2555-EZ?

Taxpayers who are eligible to file Form 2555-EZ should complete Parts I, II, and IV of the form. Complete Part III if the taxpayer was in the United States or any of its possessions during the tax year.

### How do I complete Form 2555?

Use the following guidelines when completing Form 2555.

- Part I is completed by all taxpayers
- Part II is completed by taxpayers who qualify under the bona fide residence test
- Part III is completed by all taxpayers who qualify under the physical presence test
- Part IV is completed by all taxpayers — list all foreign earned income
- Part V is completed by all taxpayers
- Part VI is completed by taxpayers claiming the housing exclusion and/or housing deduction
- Part VII is completed by taxpayers claiming the foreign earned income exclusion
- Part VIII is completed by taxpayers who have deductions allowed in figuring adjustments to gross income that are allocable to the excluded income. The three most common deductions that may affect the exclusion are:
  - One-half self-employment tax plus all expenses on Schedule C-EZ (self-employment income may be exempt from income tax but not self-employment tax)
  - Itemized deductions
  - Moving expenses



**TaxWise Hint:** Link from Form 1040, line 21 to Form 2555 or Form 2555-EZ.

Select the appropriate form for your taxpayer and complete the information needed on all pages of the form. The exclusion amount will be calculated by TaxWise and entered as a negative number on line 21 of Form 1040.

## Taxpayer Example

Look at the approved intake and interview sheet for taxpayers Jack and Jill Stetson (see Military Practice Exercises, Exercise 16, in Publication 4491-W.)

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

JILL SAYS...

*That is possible. First, we will have to determine if you meet the requirements. Were you working as a military or civilian employee of the U.S. Government?*

*Great, that would qualify, but Jack's military pay won't. [Volunteer links to Form 2555-EZ on TaxWise.] Let's see. You are a U.S. Citizen. You earned wages in a foreign country and the total was less than \$87,600. You have no self-employment income or business/moving expenses and since you lived on base, you won't have a foreign housing exclusion. OK, we can use Form 2555-EZ.*

*Now we have to determine if you meet the bona fide residence or physical presence test and if your tax home is in a foreign country.*

*Don't worry, I just need to ask you a few questions. How long did you say you were in Germany?*

*No problem then. You were living in Germany for the entire year so you are considered a bona fide resident in 2008. Since your home and place of employment were both in Germany, you meet the tax home test. Now, what was your address while you were living in Germany?*

*What did you do for Bavaria Advertising?*

*Do you have Bavaria Advertising's address?*

*Were you present in the U.S. during 2008? I have to enter the dates on this form.*

[On page 2 of the approved intake and interview sheet, indicate Jill's responses to these questions.]

Will we be able to exclude any of my income on our tax return? I worked for Bavaria Advertising in Munich this past year and made \$24,000 in U.S. dollars. I heard that you don't have to pay taxes on income earned in a foreign country and I've never done this before.

No, Bavaria Advertising is a foreign company owned by a family right there in Munich.

Yeah, that all sounds right.

I sure hope you know what you are doing, it sounds complicated to me.

We moved on base in Germany on March 3, 2007 and just returned to the states on January 10, 2009.

1567 Albion Street, Munich.

I was a copywriter.

I sure do, it is right here on this statement.

Not in 2008. But we did come home for the holidays in 2007.

## Summary

Total income from all sources is entered on:

- Line 22 (Form 1040, lines 7 – 21)
- Line 15 (Form 1040A, lines 7 – 14)
- Line 4 (Form 1040EZ, lines 1 – 3) (total income is the same as adjusted gross income)

Taxpayers are sometimes alarmed at how high their total income is. If this happens, reassure the taxpayer that the return is not finished yet! It is very likely that adjustments, deductions, and credits will considerably reduce the total tax owed.

Line 21, Other Income, includes any taxable income for which there is not a specific line identified in Lines 7 through 20 of Form 1040.

U.S. citizens and resident aliens are taxed on worldwide income. They must file a U.S. tax return even if all the income is from foreign sources, and even if they pay taxes to another country.

When taxpayers living abroad receive income in foreign currency, the amounts reported on the return must be converted into U.S. dollars. The exchange rates used should reflect the closest accurate rate.

If the taxpayer is eligible to exclude some or all of his/her foreign earned income, then Form 2555 or Form 2555-EZ will be completed. The excludible amount will be entered as a negative number on line 21 to offset the income reported on line 7 or line 12.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



### EXERCISE ANSWERS

**Answer 1:** D. Marta's gross income includes her wages, interest, and unemployment compensation, all of which should be reported on her tax return.

**Answer 2:** C. Mary's gross income includes her wages, interest, and alimony, all of which should be reported on her tax return. Her child support payments are her only nontaxable income.

**Answer 3:** A. Dividing 200 Euros by the .75514 exchange rate comes to \$264.85.



## EXERCISE ANSWERS (continued)

**Answer 4:** C. Dividing 36,000 Euros by the .7000 exchange rate comes to \$51,428.57.

**Answer 5:** No. Miranda is not eligible for the foreign earned income exclusion because Puerto Rico is not a foreign country.

**Answer 6:** True. Generally, the tax home is the country in which taxpayers maintain their place of business. Because Alan works in China, it is considered to be his tax home. For taxpayers who do not have a regular place of business because of the nature of the work, their tax home is the place where they regularly live.

**Answer 7:** No. Stan is considered to have an abode in the United States and does not satisfy the tax home test in the foreign country. He is not eligible for the foreign earned income exclusion.

**Answer 8:** Yes. Since Zach went to Spain to work and has established a permanent residence there with his wife, he meets the bona fide residence test.

**Answer 9:** No. Social security benefits, pension, and dividends do not qualify as earned income; therefore, Juanita does not qualify for the foreign earned income exclusion.

**Answer 10:** B. Since Mallory's earned income is less than \$87,600, she can file Form 2555-EZ.





### Introduction

This lesson will help you determine which income items received by members of the U.S. Armed Forces are reportable on the return, and the status of any medical separation pay or pay related to service in a combat zone.

Community property laws may impact the income reported by some military members on their returns.

To identify these types of income, use the interview techniques and tools discussed in the Screening and Interviewing lesson.

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- Which income items received by members of the U.S. Armed Forces are reportable on the tax return, and
- The status of any medical separation pay or pay related to service in a combat zone

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 3
- ☐ Publication 525
- ☐ Publication 527
- ☐ Publication 555
- ☐ Publication 4491-W

### What are the types of income?

U.S. Armed Forces members receive many different types of pay and allowances. Some are includible in gross income while others are excludible from gross income.

Refer to Tables 1 and 2 of Publication 3, Armed Forces' Tax Guide, for detailed lists of these types of military pay and to determine if they are included in gross income, or excluded.



If the amount shown in box 1 of Form W-2 differs from the last Leave and Earnings Statement for 2008, advise the taxpayer to contact the local accounting and finance or payroll office for an explanation.

### What income is includible?

Includible items are subject to tax and must be reported on the taxpayer's tax return. The items listed in Table 1 of Publication 3 are included in gross income, unless the pay is for service in a combat zone or in a qualified hazardous duty area. All includible military income will generally be shown in box 1 of Form W-2 and reported on line 7 of Form 1040.

## What income is excludible?

Excludible income does not have to be reported as income on Form 1040, Form 1040A, or Form 1040EZ. The exclusion applies whether or not the item is furnished in kind or is a reimbursement or allowance.

For example, the Basic Allowance for Housing (BAH) can be excluded from gross income as a qualified military benefit. Excludible income will not be included in the amount in box 1 on Form W-2.



If U.S. Armed Forces members were provided a commuter highway vehicle (such as a van) by their employer, refer them to Publication 525, *Taxable and Nontaxable Income*, and to a professional tax preparer.



## EXERCISES

Answers follow the lesson summary.

**Question 1:** You need to account for enlistment and reenlistment bonuses separately when preparing a service member's tax return because the income information is not shown on Form W-2. Refer to Publication 3. ☐ True ☐ False

**Question 2:** Which of the following items is excludible from U.S. Armed Forces members' income?

- A. Student loan repayments
- B. Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS) income
- C. Basic pay
- D. Hardship duty pay

## What is military separation with disability severance pay?

Disability severance pay has varying effects on a service member's income and taxes.

## What is severance pay?

U.S. Armed Forces members who have been separated from the service after years of service or for medical reasons are given severance pay, which is generally taxable as wages. If the member receives disability severance pay and is later awarded Veteran's Affairs (VA) disability benefits, up to 100% of the disability severance benefit may be excluded from income. The VA makes the determination that the member is entitled to medical disability benefits, and the determination process can take several months, and sometimes years.

## What is VA disability compensation?

VA disability compensation is a monetary benefit paid to veterans who are disabled because of injury or disease incurred or aggravated during active military service. The service of the veteran must have been terminated through separation or discharge under honorable conditions. Disability compensation varies with the degree of disability and the number of dependents, and is paid monthly. The benefits are not subject to federal or state income tax.

## What happens after a service member receives a letter of determination?

Once the VA sends a letter of determination, all future pension payments from the government are offset by the disability amount paid directly from the VA. Disability payments received directly from the VA are not taxable and are not included in Form W-2 or Form 1099-R. The amount of the disability benefit is calculated by the VA, based on the percentage of disability and other factors.

Although pension payments made before the letter of determination was issued have already been taxed, the letter exempts from taxes the same percentage of previous pension payments. U.S. Armed Forces members who have already filed a tax return and reported that pension income should file Form 1040X, Amended U.S. Individual Income Tax Return and attach a copy of the letter of determination.



### EXERCISES (continued)

**Question 3:** Disability payments sent directly from the VA to the discharged service member \_\_\_\_\_.

- A. Are taxable
- B. Appear on the taxpayer's Form W-2 or 1099-R
- C. Are not included on the taxpayer's Form W-2 or 1099-R
- D. May begin before the VA issues the letter of determination

### example

Anita Zapata was an active duty service member who was separated due to a medical condition, and began receiving her military pension in February 2007. Here are the payments she reported on her 2007 tax return:

<i>Payments</i>	<i>Amount</i>
• Disability severance pay	\$10,000
• Service pension	\$33,000
• Active duty pay	\$ 5,000

In 2008, the VA determined that she was retroactively entitled to a VA disability pension of \$837 each month from the date of her discharge (February 2007). She can amend her 2007 tax return to exclude \$9,207 (\$837 x 11 months) of the pension she received plus the entire \$10,000 disability severance payment.

She must attach a copy of her letter of determination to the amended return. Her 2008 Form 1099-R will not include the nontaxable VA disability retirements received during 2008.

## What is a combat zone?

A combat zone is any area the President of the United States designates by Executive Order as an area in which the U.S. Armed Forces are engaging or have engaged in combat. An area becomes a combat zone and ceases to be a combat zone on the dates the President designates by Executive Order. Publication 3 lists the specific areas and dates.

Hazardous duty areas are determined by Congress. Members of the Armed Forces deployed overseas, away from their permanent duty station, in support of operations in a qualified hazardous duty area, or performing qualifying service outside the qualified hazardous duty area, are treated as if they are in a combat zone for federal income tax purposes.

### **What is the combat zone exclusion?**

Members of the U.S. Armed Forces who serve in a combat zone may exclude certain pay from their income. The entitlement to the pay must have fully accrued in a month during which they served in the combat zone or were hospitalized due to wounds, disease, or injury incurred while serving in the combat zone. They do not have to receive the pay while in a combat zone, in a hospital, or in the same year they served in a combat zone.

The following section is to help you understand when pay is considered excludable as combat pay. You will not be making any decisions about what is excludable. The information on the military member's Form W-2 indicates the amount of combat pay with a code Q. If military members feel the amount is incorrect, refer them to the local accounting and finance or payroll office for clarification. Do not change any amounts on the Form W-2 when inputting in TaxWise.

### **What qualifies as service in a combat zone?**

Service in a combat zone includes periods that military members are absent from duty because of illness, wounds, or leave. If, as a result of serving in a combat zone, military members become prisoners of war or are missing in action, they are considered to be serving in the combat zone as long as they keep that status for military pay purposes.

### **When does service outside a combat zone qualify as service inside a combat zone?**

Military service outside a combat zone is considered to be performed in a combat zone if the service:

- Is in direct support of military operations in the combat zone, and
- Qualifies a member for hostile fire/imminent danger pay due to dangers or risks from the combat zone

Military pay received for this service will qualify for the combat zone exclusion if the other requirements are met.

### **What is nonqualifying presence in a combat zone?**

The following military service does not qualify as service in a combat zone:

- Presence in a combat zone while on leave from a duty station located outside the combat zone
- Passage over or through a combat zone during a trip between two points that are outside a combat zone, and
- Presence in a combat zone solely for a member's personal convenience



U.S. service members are considered to be serving in a combat zone if they are either assigned on official temporary duty to a combat zone or they qualify for hostile fire/imminent danger pay while in a combat zone.

### example

Sgt. Bobby Osage was not assigned to a combat zone but he did duty that was qualified for hostile fire pay. He can exclude that income.



### EXERCISES (continued)

**Question 4:** Which of the following may qualify as service in a combat zone?

- A. Temporary duty in a combat zone
- B. Traveling through a combat zone between two points outside of the combat zone
- C. Presence in a combat zone while on leave from a duty station located outside the combat zone
- D. Direct support of a qualified hazardous duty area, but not entitled to hostile fire/imminent danger pay.

### What is the amount of the combat zone exclusion?

- Enlisted members, warrant officers, or commissioned warrant officers who serve in a combat zone during any part of a month (even if it's only one day) can exclude all of that month's military pay, including awards and re-enlistment bonuses for which the member becomes eligible while in the combat zone. Military pay earned while hospitalized due to wounds, disease, or injury incurred in the combat zone can also be excluded.
- Commissioned officers (including limited duty officers) may exclude pay according to the rules for enlisted members. However, the amount of the exclusion is limited to the highest rate of enlisted pay plus the amount of imminent danger/hostile fire pay received for each month during any part of which they served in a combat zone or were hospitalized as a result of their combat zone service.

Combat pay is not included in box 1 wages on the service member's Form W-2, but the amount is shown in box 12 of Form W-2, with code Q. If service members believe the taxable wages on Form W-2 are incorrect, they should contact the finance office to request a corrected Form W-2. Nontaxable combat pay sometimes increases Child Tax Credit or the Earned Income Tax Credit. If using TaxWise, be sure to enter all fields on Form W-2. If filing a paper return, be sure to consider the combat pay amount when calculating these credits.



**TaxWise Hint:** On the Main Information Sheet, just above the Presidential Campaign Information section, there is a line for "Special Military Processing." If the taxpayer served in a combat zone during the tax year, click on this box and select the name of the combat zone from the dropdown menu, or choose "Combat Zone." This will identify the return to the IRS, and can avoid certain reject conditions, such as federal withholding exceeding 50% of the wage amount.

## Taxpayer Example

The Military Comprehensive Problem in the workbook has an example of Form W-2 with combat pay excluded. Here's how a volunteer might help a taxpayer that has combat pay:

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Let's talk for a minute about where your husband was stationed.*

*The combat pay is not taxable, but it's shown on your husband's W-2 – here in box 12, with Code Q. I will enter that into the system with the rest of the W-2 information, because combat pay can increase some tax credits. I can show on the tax return that he was in the combat zone, but I don't need to know the exact dates. Is he serving in Operation Iraqi Freedom?*

#### MRS. SIERRA RESPONDS...

My husband was in a combat zone for part of the year. Do I need to tell you the dates or anything?

That's right.

## What are the laws regarding community property?

The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Special rules apply to married taxpayers who file separately or who were divorced during the tax year and were domiciled in a community property state.

## How do community property laws affect Armed Forces pay?

Married taxpayers who choose to file separately, when subject to community property rules, have to figure community income and separate income for state and federal income tax.

State community property laws apply to active military pay. Generally, the pay is either separate or community income based on the marital status and domicile of the couple while the service member was/is in active military service.

For military members residing in community property states, the key word is domicile. Domicile describes someone's legal, permanent residence. It is not always where the person presently lives.

Whether an item is subject to community property laws depends on whether the payment is classified as active pay or retired/retainer pay:

- State community property laws apply to active military pay. Generally, the character of the pay as separate from community income is determined by the marital status and domicile of the service member and spouse while the member is on active military service.
- Armed Forces retired or retainer payments may be subject to community property laws. For more information see Publication 555, Community Property.

## Summary

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Special rules may govern whether certain income received by members of the U.S. Armed Forces is includible or excludible from taxable income reported on the return:

- Medical separation with disability severance pay
- Combat zone exclusion
- Community property laws



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Military - Sierra
2. International - Holmes



### EXERCISE ANSWERS

*Answer 1: False. The payments and withholdings for the enlistment and reenlistment bonuses are reflected on the service member's Form W-2.*

*Answer 2: B. The basic allowance for housing (BAH) and basic allowance for subsistence (BAS) are both nontaxable income.*

*Answer 3: C. Once the VA sends the letter of determination, all pension payments are offset by the disability amount paid directly from the VA, which is not taxable and not included in any Form W-2.*

*Answer 4: A. Military members are considered to be serving in a combat zone if they are either assigned on official duty to a combat zone or they qualify for hostile fire/imminent danger pay while serving in direct support of a combat zone.*



[illegible]



### Introduction

This lesson will help you determine which, if any, adjustments to income a taxpayer is eligible to claim on their return. Adjustments to income are amounts that a taxpayer can subtract from total income. The result is an “adjusted gross income” which is used to figure the taxpayer’s tax. Adjustments are different from tax credits. Adjustments are applied to reduce income before figuring the tax; credits are subtracted directly from the tax liability.

To identify the adjustments to income that a taxpayer can claim, you will need to ask the taxpayer if they had the types of expenses listed on the Adjusted Gross Income section of Form 1040, U.S. Individual tax Return. To determine the taxpayer’s adjustments to income, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Review the taxpayer’s answers on their approved intake and interview sheet.

During the tax year did the taxpayer or spouse:

- Receive income from self-employment?
- Pay a penalty for early withdrawal of savings?
- Pay alimony?
- Make contributions to a traditional IRA?
- Pay student loan interest?
- Receive income from jury duty that was turned over to an employer?

See the Volunteer Resource Guide for the TaxWise screens referenced in this lesson.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify which adjustments are within the scope of the VITA/TCE Program
- Calculate and accurately report the adjustments to income that are within the scope of the VITA/TCE Program

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W

#### Optional:

- ☐ Publication 504
- ☐ Publication 590
- ☐ Publication 970
- ☐ Form 1040 Instructions
- ☐ Form 1040
- ☐ Form 1040A
- ☐ Form 1040EZ
- ☐ Form 1040 (Sch SE)
- ☐ Form 1098-E
- ☐ Form 1099-INT
- ☐ Form 1099-OID
- ☐ Form 8606
- ☐ IRA Deduction Worksheet

## What are the adjustments on Form 1040?

Form 1040 provides the largest number of adjustments to income. They are found in the *Adjusted Gross Income* section on page 1 of the form. In this lesson, you will learn how to identify and work with these adjustments:

- One-half of self-employment tax
- Penalty on early withdrawal of savings
- Alimony paid
- IRA deduction
- Student loan interest deduction
- Jury duty pay turned over to taxpayer's employer

There are other adjustments to income on Form 1040. In general, these are beyond the scope of the VITA/TCE program. If you believe a taxpayer could benefit from one of these other adjustments, encourage the taxpayer to consult a professional tax preparer.

You can see the TaxWise entry screen for Adjustments to Income in the Volunteer Resource Guide (Tab 3).



**TaxWise Hint:** When using TaxWise, always select Form 1040. It provides options to deal with the widest range of taxpayer possibilities. Form 1040A, U.S. Individual Tax Return, allows fewer adjustments to income, and Form 1040EZ, U.S. Individual Tax Return, allows no adjustments. After completion of the return, you may select a simpler form, i.e. 1040A or 1040EZ, by returning to the Main Information Sheet.

## How do I handle self-employment tax?

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### Where do I get this information?

Self-employed taxpayers can subtract half of their self-employment tax from their income. (This is equal to the amount in social security tax and Medicare tax that an employer pays for an employee, and which is excluded from an employee's income.)

If, based on the interview, you establish that the taxpayer and/or spouse has self-employment income, work with the taxpayer to calculate the self-employment tax using Form 1040 (Schedule SE), Self-Employment Tax; this is covered in Lesson 28, Other Taxes.

### How do I report this information?

Enter half of the self-employment tax from line 6 of Schedule SE on Form 1040, line 27.



**TaxWise Hint:** TaxWise automatically figures half the self-employment tax and displays it on line 27.

## How do I handle penalties for early withdrawal?

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### Where do I get this information?

Taxpayers can adjust their income to deduct penalties they paid for withdrawing funds from a deferred interest account before maturity. Ask if the taxpayer and/or spouse made any early withdrawals during the tax year. If so, ask to see Form 1099-INT, Interest Income, or Form 1099-OID, Original Issue Discount, documenting the penalty.

### How do I report this information?

If you're using TaxWise, you should have entered the early withdrawal penalty amount when you entered the interest received on TaxWise's Interest Stmt-Schedule B (see hint). If preparing a paper return, enter the penalty amount on line 30 of Form 1040.

#### example

In 2008, Gloria withdrew \$5000 early from a one-year, deferred-interest certificate of deposit. She had to pay a penalty of three months' interest. She can claim this penalty amount as an adjustment to income.



**TaxWise Hint:** From line 8a or line 30, link to Schedule B. From Schedule B, line 1b, link to Interest Stmt-Schedule B. Enter the amount from Form 1099-INT, box 2 in the Early Penalty column. TaxWise displays the calculated penalty amount on line 30.

## How do I handle alimony paid?

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### Who is eligible for this deduction?

Alimony is a payment to a spouse or former spouse under a divorce or separation instrument. The payments do not have to be made directly to the ex-spouse. For example, payments made on behalf of the ex-spouse for expenses specified in the instrument, such as medical bills, housing costs, and other expenses can qualify as alimony. Alimony does not include child support or voluntary payments outside the instrument. The person paying alimony can subtract it as an adjustment to income; the person receiving alimony must treat it as income.

A summary of the alimony requirements can be found in the Adjustments section of the Volunteer Resource Guide (Tab E).

### Where do I get this information?

When you conduct the interview, ask if the taxpayer paid alimony under a divorce or separation instrument. If so, explain that you need the exact amount, as well as the social security number of the recipient, because the recipient must report the payment to the IRS as income and the two amounts must agree.

### example

Anthony has been divorced for three years. Under his divorce instrument, he paid his ex-wife \$12,000 in 2008. As a favor, he also made \$2400 in payments to cover part of her vehicle lease so she could keep steady employment. He can take the \$12,000 as an adjustment to income. He cannot count the lease payments because those were payments not required by the divorce instrument.

## How do I report this information?

Enter the alimony amount paid on line 31a and the recipient's social security number on line 31b.

For additional information on alimony, refer to the Alimony chapter in Publication 17 and Publication 504, Divorced or Separated Individuals.



**TaxWise Hint:** If the taxpayer paid alimony to more than one person, from Form 1040 line 31a link to the Alimony Paid Worksheet. TaxWise will display the total for all alimony payments on line 31a.



## EXERCISES

Answers are at the end of the lesson summary.

**Question 1:** Victoria divorced in 2005. Her divorce settlement states that she must pay her ex-husband \$15,000 a year. She is also required to pay his ongoing medical expenses for a condition he acquired during their marriage. In 2008, the medical expenses were \$11,345. How much can she deduct as an adjustment to income?

- A. \$15,000
- B. \$11,345
- C. \$26,345
- D. \$3,655

## How do I handle IRA contributions?

### What is an IRA?

Be sure to ask if the taxpayer contributed to an IRA. "IRA" stands for "Individual Retirement Arrangement." It is a personal savings plan that offers tax advantages to set aside money for retirement. This section discusses "traditional" IRAs. A traditional IRA is any IRA that is not a Roth or SIMPLE IRA. See the Individual Retirement Arrangements (IRAs) chapter in Publication 17, and Publication 590, Individual Retirement Arrangements, for more information on all types of IRAs.

Some of the features of a traditional IRA are:

- Taxpayers may be able to deduct some or all of their contributions to the IRA (depending on circumstances).
- Generally, amounts in an IRA, including earnings and gains, are not taxed until distributed.
- Contributions may be eligible for the Retirement Savings Credit.

Although contributions to a Roth IRA can't be deducted, the taxpayer may be eligible for the Retirement Savings Contribution Credit, discussed in the lesson on Miscellaneous Credits.

#### example

Fred has a traditional IRA account, and a Roth IRA account. In 2008, Fred contributed \$2,200 to his traditional IRA, and \$1,000 to his Roth IRA. The most Fred will be able to deduct is the \$2,200 contribution to his traditional IRA.

### What are the eligibility requirements for an IRA contribution?

The taxpayer, and the taxpayer's spouse if applicable, must meet these eligibility requirements in order to make an IRA contribution:

- **Types of IRAs:** Verify the types of IRAs that the taxpayer and spouse contributed to. Only contributions to traditional IRAs are deductible.
- **Age limit:** Taxpayers can contribute to a traditional IRA only if they are less than 70-1/2 years of age at the end of the tax year. Check the taxpayer's birth date (and spouse's if applicable) indicated on the approved intake and interview sheet. To meet the age requirement for 2008, a taxpayer must have been born on, or after, July 1, 1938.
- **Compensation:** Individuals must have taxable compensation (wages, self-employment income, commissions, taxable alimony, and taxable scholarships or fellowships).
- **Time limits:** Contributions must be made by the due date for filing the return, not including extensions. Verify with the taxpayer and spouse that they made the contribution(s) (or will make them) by April 15, 2009.

#### TIP

Be sure the taxpayer knows that if a contribution is reported on the 2008 return but is not made by the deadline, the taxpayer must file an amended return.

### How much can a taxpayer contribute to an IRA?

There is a limit to the amount that a taxpayer can contribute to an IRA each year. The total contribution (combined contributions to all accounts, including Roth and traditional IRAs) cannot be more than the **smaller** of:

- \$5,000 (\$6,000 for a person who is age 50 or older by the end of the tax year)
- The individual's taxable compensation

### What is the compensation requirement?

Compensation is generally the income a taxpayer has earned from working; it also includes alimony, and other forms of income. (See Publication 17 for more information on compensation.) Taxpayers cannot make IRA contributions that are greater than their compensation for the year.

If taxpayers file a joint return, and one spouse's compensation is less than the other spouse's compensation, the most that can be contributed for that spouse is the lesser of:

- \$5,000 (\$6,000 if age 50 or older), or

- The total compensation includible in the gross income of both spouses for the year, reduced by:
  - Traditional IRA contributions for the spouse with the greater compensation
  - Any contribution for the year to a Roth IRA for the spouse with the greater compensation

In other words, as long as they file a joint return, married taxpayers' combined IRA contributions cannot exceed their combined compensation, and neither spouse can contribute more than \$5,000 (or \$6,000 for 50 and older) to their own IRA.

#### example

Gene and Sue are married and are both over 50 years old. Gene earned \$70,000 and Sue earned \$1,500. In 2008, Gene contributed \$3,500 to his traditional IRA and \$2,000 to a Roth IRA, making his total contributions \$5,500. To figure the maximum contribution to Sue's IRA, use a total compensation of \$66,000 (that is, \$71,500 - \$5,500). If Gene and Sue file jointly, they can contribute up to \$6,000 to Sue's IRA even though her own compensation was just \$1,500.

Although a person may have IRA accounts with several different financial institutions, the tax law treats all of their traditional IRA accounts as one single IRA.

#### example

Bill is 29. He has a traditional IRA account at City Home Savings Bank, and another traditional IRA account through his stockbroker. He also opened a Roth IRA through his stockbroker. Bill can contribute to any or all of his accounts this year, but the combined contributions for 2008 cannot exceed \$5,000.



### EXERCISES (continued)

**Question 2:** Stan is 47; he contributed \$1,000 to a Roth IRA. What is the maximum he can contribute to a traditional IRA?

- A. \$3,000
- B. \$4,000
- C. \$1,000
- D. \$2,000

**Question 3:** Bob and Carol are married and both are 55 years old. They both work and each has a traditional IRA. In 2007, Bob earned \$2,000 and Carol earned \$50,000. If they file separate returns, what is the maximum that Bob can contribute to his IRA? \_\_\_\_\_

**Question 4:** If Bob and Carol (from Question 3) file jointly, what is the maximum they can contribute to Bob's IRA? \_\_\_\_\_

What is the maximum they can contribute to both of their IRAs? \_\_\_\_\_



## Special Rules for Certain Military Personnel

Current or former members of the Armed Forces may qualify for additional retirement benefits. Under the Heroes Earned Retirement Opportunities (HERO) Act taxpayers can count tax-free combat pay when determining whether they qualify to contribute to either a Roth or traditional IRA. Before this change, members of the Armed Forces whose earnings came entirely from tax-free combat pay were generally barred from using IRAs to save for retirement.

Members of the Armed Forces serving in Iraq, Afghanistan, and other combat zone localities can now contribute to an IRA, even if they received tax-free combat pay. In addition, the HERO Act allows military personnel who received tax-free combat pay in 2004 or 2005 to go back and make IRA contributions for those years. Eligible members of the Armed Forces will have extra time, until May 28, 2009, to make these special back-year contributions.

If a return has already been filed for a particular year, contributions should be reported on an amended return, Form 1040X. Depending upon the circumstances, Armed Forces members who choose to put money into a traditional IRA for 2004 or 2005 may qualify for additional tax refunds.

### When can IRA contributions be deducted?

Make sure you are discussing a traditional IRA with the taxpayer. Deductions cannot be taken for contributions to other types of IRAs. The taxpayer's deduction for IRA contributions may be "phased out" (that is, reduced or eliminated) depending on their income, filing status, and whether the taxpayer is covered by a retirement plan at work. The difference between the permitted contributions and the IRA deduction, if any, is the taxpayer's nondeductible contribution. Form 8606, Nondeductible IRAs, must be completed for any nondeductible contributions.

If taxpayers do not report nondeductible contributions, all of the contributions to a traditional IRA will be treated as having been deducted. This means all distributions will be taxed when withdrawn unless the taxpayer can show, with satisfactory evidence, that non-deductible contributions were made.

Form 8606 requires basis information in IRAs from prior years and can be complex. If Form 8606 is required, refer the taxpayer to a professional tax preparer.

### How do I determine the deduction amount?

You will help taxpayers determine if they qualify to deduct all or part of their traditional IRA contributions from their income. The factors that affect whether traditional IRA contributions are deductible include:

- Whether the taxpayer (or spouse, if filing a joint return) is covered by a retirement plan at work. Review the tables in the Adjustment tab of the Volunteer Resource Guide (Tab E). These tables are also in the IRA chapter of Publication 17.
- The taxpayer's Modified Adjusted Gross Income (MAGI) before taking the deduction. If the taxpayer or spouse is covered by a retirement plan, the deduction amount will be reduced or eliminated if the MAGI on the tax return is above a certain limit. Use the IRA Deduction Worksheet from Form 1040 Instructions to figure their MAGI without the deduction.



**TaxWise Hint:** TaxWise provides an electronic IRA Deduction Worksheet that mirrors the printed version. Link to the worksheet from Form 1040 line 32.

## How do I complete the IRA Deduction Worksheet?

If the taxpayer and spouse meet the general eligibility requirements, continue the interview by using the IRA Deduction Worksheet, found in the Form 1040 Instructions, as your guide.

### ***Retirement coverage at work***

Ask if the taxpayer and/or spouse were covered by a retirement plan at work at any time during 2008 (worksheet step 1). If so, their deduction may be limited. Employees covered by a retirement plan will have box 13 on Form W-2 checked.

If the taxpayer (or spouse, on a joint return) is not covered by a retirement plan, step 1b on the IRA Deduction Worksheet will direct you to line 7 of the worksheet, where you enter the maximum IRA contribution limit—that is, the most the taxpayer can deduct. For a joint return, complete worksheet line 7b for the spouse.

### ***Filing status and income***

If the taxpayer or spouse is covered by a retirement plan, the worksheet will show the income limits for deducting IRA contributions, based on the filing status of the return. The worksheet will also help you calculate the MAGI, by subtracting certain other adjustments to income from the total income on the return. Notice that the income limitation amount on line 2 may be different for each spouse on a joint return, but that the MAGI computation is the same. This is because if one spouse is covered by a retirement plan but the other is not, the non-covered spouse will have a higher income limit before their IRA deduction is phased out.

If the MAGI is greater than the income limits, line 6 of the worksheet tells you that the deduction cannot be taken. If this is the case, explain to the taxpayers and answer any questions they may have about why the deduction cannot be taken. The contribution may still be made, it is just not deductible.

If the deduction is allowed, continue the calculation to determine if the taxpayer is entitled to a full deduction or a partial deduction. The entry on line 7a (and line 7b if a joint return) represents the maximum allowable deduction for that taxpayer.

Line 8 of the worksheet asks you to enter the earned income shown on the return. This calculation determines the amount of compensation earned by the taxpayer(s). If the taxpayers are married and filing jointly, and their compensation is less than the maximum IRA contribution allowed, you will have to go to Publication 590 to figure their deduction. Otherwise, continue with the worksheet.

Next, on line 11, enter the total contributions to traditional IRAs that were made (or will be made) by April 15, 2009. The worksheet then helps you figure the amount that can be deducted from income.



If the taxpayer's IRA contribution is more than the lesser of \$5,000 (\$6,000 if age 50 or older) or their compensation, advise the taxpayer that their excess contributions (and all related earnings) should be withdrawn from the IRA before the due date. If the excess contributions are not withdrawn, an additional tax will be assessed. This tax on excess contributions is discussed in the lesson on Other Taxes.

## How do I report the IRA deduction?

Report the deduction on line 32 of Form 1040.



**TaxWise Hint:** Link from line 32 of Form 1040 and complete the IRA Deduction Worksheet, by entering total traditional and Roth IRA contributions in the appropriate lines. TaxWise automatically displays the contribution amount on line 32.

## What if the taxpayer has excess IRA contributions?

An excess IRA contribution is an amount contributed to a traditional IRA that is more than whichever of the following is the smaller amount:

- The taxable compensation for the year, or
- \$5,000 (\$6,000 if age 50 or older)

The taxpayer may not know that a contribution qualifies as “excess” until the tax return is completed. When this situation is identified, the excess amount, with any earnings on that amount, must be withdrawn by the due date of the return (including extensions). If the excess amount is not withdrawn by the due date of the return, the taxpayer will be subject to an additional 6% tax on this amount. This additional tax is covered in Lesson 28, Other Taxes.

The withdrawn excess contribution is not included in the taxpayer’s gross income if both of the following conditions are met:

- No deduction was allowed for the excess contribution
- All interest or other income earned on the excess contribution is withdrawn

However, taxpayers must include the earnings on the excess contribution as income on the return. This income is reported on the return for the year in which the withdrawal was made.

## How do I handle student loan interest?

### What is the deduction?

Ask taxpayers if they paid interest on any student loans during the tax year. Be sure to note the answer on page 2 of the approved intake and interview sheet. The deduction is generally the smaller of \$2,500 or the interest payments paid that year. This amount is gradually reduced (phased out) or eliminated based on the taxpayer’s filing status and MAGI, discussed later.

These limits are shown under the Adjustments tab of the Volunteer Resource Guide (Tab E).

#### example

Robert has taken his first job after completing law school. His filing status is Single. He paid \$3,000 in interest on his student loans in 2008. With all adjustments to income (except student loan interest adjustment), his MAGI is \$49,000. He can deduct \$2,500 of his student loan interest as an adjustment to income.

### example

Veronica and her husband are filing jointly. Their MAGI is \$120,000. She completed her doctoral degree in 2007 and paid \$2,400 in student loan interest in 2008. Due to their high MAGI, their deduction must be calculated; it will be less than the full amount of interest that she paid.

### What type of interest qualifies?

Generally, student loan interest is paid during the year on a loan for qualified higher education expenses. The loan must meet all three of these conditions:

- It was for the taxpayer, the taxpayer's spouse, or a person who was the taxpayer's dependent when the loan was obtained
- It was paid within a reasonable period of time before or after obtaining the loan
- It was for an eligible student

Interest does not qualify if the loan was from a related person, a qualified employer plan, or if the taxpayer is not legally liable for the loan.



### EXERCISES (continued)

**Question 5:** Todd and Janet have a MAGI of \$45,000. They are filing jointly. Two years ago, they took out a loan so Todd's mother could earn her RN degree at night school. Todd could not claim her as a dependent on his return. In 2008, they paid \$1,000 in interest on the loan. How much can they deduct from their income?

- A. \$0
- B. \$1,000
- C. \$1,500
- D. \$2,500

### Who is eligible for the deduction?

Generally, a taxpayer can claim the deduction if all the following are true:

- The taxpayer is not using the Married Filing Separately filing status
- The taxpayer will not be claimed as a dependent on someone else's return
- The taxpayer is legally obligated to pay interest on a qualified student loan
- The taxpayer paid interest on a qualified student loan
- The interest is on a loan to pay tuition and other qualified higher education expenses for the taxpayer, the taxpayer's spouse, or someone whom the taxpayer could claim as a dependent when the loan was taken out
- The education expenses were paid or incurred within a reasonable period of time before or after the loan was taken out
- The person for whom the expenses were paid or incurred was an eligible student

Conduct a probing interview to verify that they meet all these tests for the deduction.

### ***What are qualified higher education expenses?***

As part of your probing interview, ask the taxpayer an open-ended question such as “What was the student loan used to pay for?” Qualified expenses include: tuition and fees; room and board; books, supplies and equipment; and other necessary expenses (such as transportation).

Qualified expenses must be reduced by certain other educational benefits. Ask the taxpayer if the expenses were offset by any of the following:

- Employer provided educational assistance benefits
- Tax-free distributions from a Coverdell ESA or from a qualified tuition program
- U.S. savings bond interest excluded from income because it is used to pay qualified higher education expenses
- Certain scholarships and fellowships
- Veteran's educational assistance benefits
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses

### ***No Double Benefit Allowed***

Taxpayers cannot deduct as interest on a student loan any amount that is an allowable deduction under any other provision of the tax law (for example, as home mortgage interest).

### ***What is an eligible educational institution?***

An eligible educational institution is generally any accredited public, nonprofit, or private post-secondary institution eligible to participate in the student aid programs administered by the Department of Education. It includes virtually all accredited, public, nonprofit, and privately owned profit-making post-secondary institutions. If the taxpayers do not know if an educational institution is an eligible institution, they should contact the school. A searchable database of all accredited schools is available on the U.S. Department of Education web site at <http://ope.ed.gov/accreditation/>.

### ***Who is an eligible student?***

An eligible student is someone enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential. The standard for what is half the normal full-time work load is determined by each eligible educational institution.

#### **example**

In 2008, Jeremy paid interest on a loan that allowed his 21-year-old daughter, Kate, to complete a program in holistic medicine as a full-time student at the Southwestern College of Synergistic Therapy. Although she qualifies as his dependent, and the loan paid for books, supplies, and equipment, the college is not accredited. Therefore, Jeremy cannot deduct the interest on the student loan.

### ***Where can I get the information?***

If the taxpayer paid \$600 or more in interest to a single lender, the taxpayer should receive Form 1089-E, Student Loan Interest Statement, or another statement from the

lender showing the amount of interest paid. This information will assist you in completing the student loan interest deduction.

### How do I determine the deduction?

To figure the deduction, use the Student Loan Interest Deduction Worksheet for Form 1040. In TaxWise, link to the Student Loan Interest Deduction Worksheet from line 33 of Form 1040. The worksheet is included in the Form 1040 Instructions. You need documentation of all qualified student loan interest paid during the tax year, as well as any educational benefits that offset that interest.

See Publication 970, Tax Benefits for Education, for more information on the Student Loan Interest Deduction.



**TaxWise Hint:** From line 33, link to 1040-WKT2, Student Loan, Education Worksheet, and insert the amounts of student loan interest paid. The program will calculate the deductible amounts, applying the appropriate limits. It displays the total adjustment on line 33.

### Taxpayer Example

Here is how a volunteer helped Brenda determine if she can take the deduction for her student loan interest.

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*In reviewing your intake and interview sheet, I see you did not indicate if you had any educational expenses. Did you pay any student loan interest in 2008?*

*Well, you might be able to take a deduction for that. Since you are filing as Single, and your income before adjustments is not more than \$55,000, your income is not more than the limit for your filing status. Can you show me a statement from the lender?*

*The interest amounts add up to \$2,600. Now, if your interest payments qualify for the deduction, the most we can claim is \$2,500. Do you have any questions about that?*

*I just need to ask a few questions to see if you qualify, okay? Earlier we decided that you can't be claimed as a dependent on someone else's return, so that's no problem. Can you tell me what you used the loan to pay for?*

*Did you receive any educational assistance, like from your employer or the Veteran's Administration?*

*How about tax-free withdrawals from a Coverdell educational savings account, another qualified tuition program, or from U.S. savings bonds?*

*Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, which were specifically for educational expenses?*

##### BRENDA RESPONDS...

Yes, I just graduated a year ago and I'll be paying those loans for a while.

I have two loans, here are the statements.

No, I understand.

My tuition and fees, and my books.

No.

No, none of those.

Heavens, no, I wish I had!

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

BRENDA RESPONDS...

*It looks like you can claim the maximum deduction of \$2,500.*

[Indicate on the approved intake and interview sheet whether Brenda is eligible for this adjustment.]

### Is pay for jury duty an adjustment to income?

As you learned earlier, jury duty pay received by taxpayers is included in Other income on Form 1040, line 21. Some employees receive their regular wages from their employers while they are serving on a jury instead of working at their jobs.

Often, employees must turn their jury duty pay over to their employers. This may be claimed as an adjustment to income. On the paper 2008 Form 1040, there is a specific line to claim this deduction. It is reported on line 34 of the Form 1040.

### What about other adjustments to income?

There are additional adjustments to income on Form 1040. In general, these are beyond the scope of the VITA/TCE program. If you believe a taxpayer could benefit from one of these adjustments, encourage the taxpayer to consult a professional tax preparer.

### What is Adjusted Gross Income?

The taxpayer's total adjusted gross income (AGI) is the amount that is used to compute some limitations, such as the medical and dental deduction on Schedule A and the credit for child and dependent care expenses. To find the taxpayer's AGI, follow the instructions on the Form 1040:

1. Add the amounts in the far right column of the Income section (lines 7 through 21) and enter the result on line 22. This is the taxpayer's total income.
2. Add the Adjustments to Income (the amounts in lines 23 through 35) and enter the result on line 36. These are the total Adjustments.
3. Subtract line 36 from line 22. This is the AGI.



**TaxWise Hint:** TaxWise does the math for you! In fact, it keeps a running total as you work through the Income and the Adjustments sections on the screen.

### Taxpayer Example

Here is how a volunteer helped Daniela with the adjustments to income covered in this lesson.



## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

### DANIELA RESPONDS...

*Daniela, we've totaled your income, so we can go on to Adjustments to Income. We might find ways to reduce the income that you're taxed on. Do you have any questions before we go on?*

No, it all makes sense.

*Now, let's review the expenses listed on your intake and interview sheet and the deductions listed in the Adjustments to Income section of Form 1040. Do you have a Health Savings Account?*

No, I don't.

*Okay. We can skip moving expenses because you haven't moved for your job. That brings us to self-employment tax. As you can see, TaxWise has calculated half of your self-employment tax and shows it here as an adjustment to income. The same with the penalty for an early withdrawal, right? Since I put that in when I entered your interest income, it already shows up as an adjustment.*

Cool!

*Did you pay any alimony?*

No, I've never even been married.

*Now, did you contribute to an IRA?*

I put in \$2,000 right after Christmas.

*Good for you. You can contribute up to \$5,000 this year – will you be contributing any more before April 15? You can put money in your IRA for 2008 right up until the deadline for filing the return.*

I don't think so, but that's good to know.

*Was it a traditional, Roth IRA or a SIMPLE IRA?*

It was just a plain old IRA. Here's the statement.

*There we go; it is what we call a traditional IRA. You certainly are under 70½ years of age. Were you covered by any kind of employer retirement plan at any time during 2008?*

No, none.

*Because you weren't covered by a retirement plan, you will be able to deduct the full \$2,000 you contributed.*

[The volunteer reviews all expenses listed on the approved intake and interview sheet and moves down each line of the Adjustments section of Form 1040, asks more questions, and determines that Daniela does not qualify for the remaining adjustments.]

*We've entered all the adjustments that apply to you. Here is your total income... here are your total adjustments... and here is what we call your Adjusted Gross Income, that will carry over to the second page of the return where we will determine your deductions and exemption amounts.*

That's great! This program makes it really easy!.

[On the approved intake and interview sheet, note that you have addressed this adjustment.]

## Practice - Vanessa Franklin

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-17 and review the sample interview with Vanessa related to any adjustments to income that she can claim. Return to this lesson after you have reviewed this information.

## Summary

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In this lesson, you learned how to identify and work with these adjustments to income:

- One-half of self-employment tax
- Penalty on early withdrawal of savings
- Alimony paid
- IRA deduction
- Student loan interest deduction
- Jury Duty Pay turned over to the taxpayer's employer

If you believe a taxpayer could benefit from an adjustment that was not covered in this lesson, encourage the taxpayer to consult a professional tax preparer.

In this lesson, you saw that TaxWise makes it much easier to work with adjustments by providing easy access to electronic worksheets and by doing many calculations for you.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Intermediate - Yale
2. Advanced - Dalhart
3. Military - Sierra
4. International - Holmes



### EXERCISE ANSWERS

**Answer 1:** C. She can deduct the full \$26,345 because it is all required by the divorce instrument.

**Answer 2:** B. He can deduct no more than the \$4,000 contribution to the traditional IRA.

**Answer 3:** If Married Filing Separately, Bob can contribute no more than \$2,000, the amount of his compensation.



**Answer 5:** A. Because Todd's mother is not their dependent, they can deduct \$0 of the interest they paid.

## This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



## Introduction

This lesson will help you determine which members of the U.S. Armed Forces are entitled to an adjustment to income for moving expenses. To do this, you will need to determine qualifying moves, allowances and reimbursements, and deductible moving expenses.

To determine if the taxpayer has incurred moving expenses, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Although the approved intake and interview sheet may not list moving expenses, it is important to ask probing questions to see if the taxpayer may have some deductible moving expenses.

To deduct moving expenses as an adjustment to income, the taxpayer generally must meet certain time and distance tests. However, a member of the Armed Forces on active duty who moves because of a permanent change of station does not have to meet these tests.

Unreimbursed moving expenses are deducted using Form 3903, Moving Expenses. Armed Forces members receive a variety of moving reimbursements and allowances that must be considered when determining if the expenses are deductible. The travel voucher will contain much of the information needed to compute the deduction.

See Publication 521, Moving Expenses, for additional information on the topics discussed in this lesson.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify deductible moving expenses
- Determine if a move qualifies as a permanent change of station (PCS)
- Determine when allowances and reimbursements must be included in income

### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 3903

#### **Optional:**

- ☐ Publication 3
- ☐ Publication 521
- ☐ Form 1040 Instructions

## What is a permanent change of station?

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Only expenses incurred as a result of a permanent change of station (PCS) are deductible. A permanent change of station includes a move from:

- Home to the area of the first post of duty
- One permanent post of duty to another
- The last post of duty to home or to a nearer point in the U.S. The Armed Forces member must move within one year of ending active duty or within the period allowed under the Joint Travel Regulations.

## What does a permanent change of station include for spouses and dependents?

If the Armed Forces moves service members and their spouses or dependents to or from separate locations, the moves are treated as a single move and the qualified expenses of both moves are combined and deducted on the same tax return.



### EXERCISES

**Question 1:** Which of the following is a permanent change of station?

- A. A move by an Air Force pilot to an airbase for a six-month detail
- B. A move by an Army sergeant to his home two years after he ended active duty
- C. A move by a new enlistee from her home to her first post of duty
- D. A temporary move by a U.S. Marine to attend a six-month training program

## What expenses are included in the moving expense adjustment?

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Qualifying expenses are military moving expenses that fall into the following two categories. The cost of:

- Moving household goods and personal effects
- Reasonable travel and lodging expenses

To qualify as “reasonable,” the route taken must be the shortest, most direct route available, from the former home to the new home. Additional expenses for stopovers or side trips are not deductible as moving expenses.

Qualifying expenses that exceed government allowances and reimbursements are deductible.

Use Publication 521 as a resource for additional information. This publication has detailed information on deductible and nondeductible moving expenses. It also contains a special section on members of the Armed Forces.

## How do I handle military reimbursements?

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You need to determine whether any moving allowances or reimbursements provided by the government should be included in a service person's income, and how to accurately report the deduction on Form 1040.

### What is a DITY move?

Typically, Armed Forces members move their own household items, in a personal or rented vehicle. This is called a Do It Yourself (DITY) move; the most common form of military move. The Armed Forces provides an incentive payment equal to 95% of the estimated cost to the government for DITY moves. When the move is completed, the Armed Forces member provides receipts and paperwork to substantiate authorized expenses. The net financial profit is taxable, and is reported on a separate Form W-2.

### How do I report a DITY move?

DITY payments are entered as income on line 7 of Form 1040.

Armed Forces members may not take a moving expense deduction based on the expenses approved by the finance office when settling the DITY move, as they have already been used to reduce taxable income.

#### example

Captain Jones receives orders for a PCS. He chooses to pack and drive his household goods to the new duty station in his own vehicle. The Air Force estimates that the move would have cost the government \$2,500. Captain Jones' actual expenses for the move were \$1,750. He receives a payment for \$2,375 (95% of the government's estimate) but Box 1 on Form W-2 will show only \$625 (\$2,375 minus \$1,750) for the DITY move. Captain Jones cannot deduct any of his expenses, since he's already been reimbursed.

### What forms of reimbursement are *not* included as income?

Certain forms of reimbursement provided by the government are *not* to be included as income on the Armed Forces member's tax return.

- Moving or storage services furnished to the Armed Forces member
- Nontaxable allowances such as:
  - Dislocation allowance
  - Temporary lodging allowance
  - Mileage allowance in lieu of transportation
  - Per diem allowance



## EXERCISES (continued)

**Question 2:** Sgt. Sherry Bishop received Form W-2 for \$1,000 as a result of a DITY move to a new Permanent Duty Station (PDS). The government paid her a mileage allowance of \$300, a lodging allowance of \$200, and a dislocation allowance of \$1200. How much should Sgt. Bishop include in her gross income on line 7 of Form 1040?

- A. \$1,500
- B. \$1,000
- C. \$300
- D. \$200

### How do I calculate the adjustment?

Deductions can only be claimed for the amount of expenses *not* covered by a nontaxable reimbursement or moving allowance. To calculate the amount of an Armed Forces member's moving expense adjustment, complete Form 3903:

- Allowable expenses are totaled on line 3.
- All reimbursements and allowances are included on line 4.
- If the expenses are greater than reimbursements, the difference will be carried to line 26 of Form 1040, and reduce the taxpayer's Adjusted Gross Income.
- If all reimbursements were nontaxable allowances, then no amount is included in line 7 wages, even if the reimbursements were greater than the allowable expenses. When this occurs, Form 3903 is not needed.



**TaxWise Hint:** Link from line 26 of Form 1040 to access Form 3903, Moving Expenses. Check the box near the top of the form to indicate an Armed Forces PCS move. Line 2 is broken into two separate entries: one allows you to enter the miles traveled and compute the standard mileage amount; there is a separate line for "other travel costs." If you need to add together expenses or reimbursements, link from lines 1, 2 or 4 to bring up a scratch pad. If you determine that nontaxable reimbursements are greater than allowable moving expenses, remove Form 3903 before continuing with the return.



## Taxpayer Example

Refer to the Military Comprehensive Problem - Sierra in Publication 4491-W for an example of a return with military moving expenses. Here's how a volunteer could help Mrs. Sierra determine if she had any deductible moving expenses:

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*You said you just moved here during June of this year. Was this a PCS move?*

*If your expenses were more than the Armed Forces reimbursed you for, you may be able to use the difference to reduce your gross income. We'll complete Form 3903 to see how it comes out. Did you bring your travel voucher with you?*

*Did you drive directly here, or did you take any side trips?*

*The IRS will let you take a standard 19 cents a mile from January 1 through June 30, and a standard 27 cents a mile from July 1 through December 31, or we can use actual expenses, if you kept track. The standard rate would be \$190.*

*The IRS allows lodging costs, but not food. So your allowable expenses would be \$490 - \$300 for the motels and \$190 for your mileage. The travel voucher shows a total of \$400 in reimbursements – did you receive any other reimbursements or allowances?*

*Then you'll get to deduct \$90, the amount you spent that was more than your reimbursements.*

[On the approved intake and interview sheet, be sure to note that you've addressed this adjustment.]

#### MRS. SIERRA RESPONDS...

Yes, my husband was transferred here shortly before he deployed. I have family close by, so I'd rather stay here while he's overseas.

It's right here. We drove our own car 1,000 miles to get here, and paid \$120 for gas. We paid \$300 for motels and \$165 for meals on the way. The military moved our household goods, and we didn't have any overweight.

We came right here so we could settle in before he deployed.

I only kept the gas receipts, so the standard would probably be best.

No, that's it.

<b>Form 3903</b> Department of the Treasury Internal Revenue Service (99)	<b>Moving Expenses</b> ▶ Attach to Form 1040 or Form 1040NR.	OMB No. 1545-0074 <b>2008</b> Attachment Sequence No. <b>62</b>
Name(s) shown on return		Your social security number
<b>Before you begin:</b> <ul style="list-style-type: none"> <li>✓ See the <b>Distance Test</b> and <b>Time Test</b> in the instructions to find out if you can deduct your moving expenses.</li> <li>✓ See <b>Members of the Armed Forces</b> on the back, if applicable.</li> </ul>		
<b>1</b> Transportation and storage of household goods and personal effects (see instructions)	<b>1</b>	
<b>2</b> Travel (including lodging) from your old home to your new home (see instructions). <b>Do not</b> include the cost of meals	<b>2</b>	

When should an Armed Forces member claim the deduction?

Armed Forces members who use the cash method of accounting and who are reimbursed for their expenses can deduct the expenses either in the year they were paid or in the year the reimbursement was received. They can choose to deduct the expenses in the year of reimbursement even if they paid the expenses in a different year.

If expenses are deducted and the reimbursement is received in a later year, the reimbursement must be included in income.

Armed Forces members who use the cash method of accounting (the most common) can deduct moving expenses in the year of reimbursement if the expenses were paid in the year:

- Before the year of reimbursement, or
- Immediately after the year of reimbursement but by the due date, including extensions, for filing the return for the reimbursement year



EXERCISES (continued)

**Question 3:** In December 2008 Petty Officer Ben Wharton moved from California to Washington. The move qualified as a PCS. He incurred \$800 in mileage expenses and \$1600 in lodging. He paid \$1400 to ship household goods over the allowed weight limit, and \$500 to ship his dog. He filed his travel voucher in January, 2009, and received \$2400 mileage and travel allowance. He also received a \$1500 dislocation allowance.

For what tax year(s) can Petty Officer Wharton claim his moving expenses on Form 3903?

- A. 2008 only
- B. 2009 only
- C. Either 2008 or 2009

Taxpayer Example

Greg was relocated to another Air Force base. Here’s how a volunteer could help Greg determine if he had any deductible moving expenses:

SAMPLE INTERVIEW

VOLUNTEER SAYS...

*So, you were transferred from Maxwell Air Force Base to Scott Air Force Base last year, right?*

*Did you receive any other allowances?*

*Well the reimbursements were not reported on your W-2. You can only deduct expenses that are larger than your combined reimbursements and allowances. First, let’s add all your qualified expenses. How much was your travel and lodging?*

GREG RESPONDS...

Yes, I was reimbursed \$400 for travel expenses on the way to Scott Air Force Base.

Yes, I also received a \$1,000 dislocation allowance.

I spent \$575 on travel and lodging and another \$200 for meals along the way.

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

*Any other expenses?*

GREG RESPONDS...

Yes, I gave a \$350 security deposit to my new landlord.

*Only the travel and lodging en route can be claimed on Form 3903, line 2. The security deposit and meals are not deductible expenses. Your reimbursement and dislocation allowances add up to \$1,400. Since that's more than your expenses, you don't have anything to deduct. But, you don't have to include any of the excess reimbursement as income, either.*

## Summary

This lesson described the types of Armed Forces moves that qualify for tax benefits, what kinds of expenses are deductible, and how to use Form 3903 to compute the moving expense deduction. These expenses are deductible as an adjustment to income on Form 1040, line 26.

## 2008 Moving Mileage Rates

Rates 1/1/08- 6/30/08	Rates 7/1/08- 12/31/08
19 cents/mile	27 cents/mile



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you covered all the technical topics.



**Answer 2: B.** The \$1,000 DITY payment should be included as gross income on line 7. However, nontaxable allowances such as dislocation allowances, temporary lodging allowances and mileage allowances provided by the Armed Forces should not be included as gross income on the service member's tax return, even if they exceed allowable expenses.

## Notes

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



## Introduction

This lesson will help you determine the dollar amounts for the standard deduction that are adjusted based on the rate of inflation each year.

The dollar amount is based on the taxpayer's filing status, age, and other factors that will be covered in this lesson.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine the standard deduction amount for taxpayers
- Determine the standard deduction amount for taxpayers claimed as dependents
- Identify how taxable income and income tax are computed and reported

### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 1040
- ☐ **Optional:** Publication 501

## What are deductions?

Deductions are subtractions from a taxpayer's adjusted gross income (AGI). They reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing their deductions. When taxpayers have a choice, they should use the type of deduction that results in the lower tax. Use the interview techniques and tools discussed in earlier to assist you in determining if the standard deduction will result in the largest possible deduction for the taxpayer.

## What is a standard deduction?

A standard deduction is a predefined dollar amount that applies to taxpayers who meet certain general requirements. It eliminates the need to maintain records for specific itemized deductions and is easy to determine. The standard deduction amount is based on taxpayers' filing status, whether they are 65 or older and/or blind, paid real estate taxes, or an exemption can be claimed for them by another taxpayer. The standard deduction amounts are listed in the left margin of Form 1040, U.S. Individual Income Tax Return page 2, and can be located in Publication 4012, Volunteer Resource Guide (Tab F).

The standard deduction is generally lower for taxpayers who can be claimed as a dependent on another taxpayer's return. The standard deduction is higher for people who are 65 or over, blind, or partially blind.



## EXERCISES

Use the Standard Deduction for Most People chart in the Volunteer Resource Guide (Tab F) to complete the following exercises. Answers are at the end of the lesson summary.

**Question 1:** Susan is single, cannot be claimed by another taxpayer, and has no itemized deductions. What is her standard deduction for the tax year?

- A. \$5,450
- B. \$7,850
- C. \$3,000

**Question 2:** Henry has two children and qualifies for the Head of Household filing status. He will not itemize any deductions this tax year. What is his standard deduction for the tax year?

- A. \$5,450
- B. \$8,000
- C. \$10,700

### What is an itemized deduction?

Itemized deductions allow taxpayers to reduce income based on specific personal expenses. If the total itemized deductions are greater than the standard deduction, it will result in a lower taxable income and lower tax. In general, taxpayers benefit from itemizing deductions if they have mortgage interest, very large unreimbursed medical/dental expenses (when compared to their income), or other large expenses such as charitable contributions. Itemized deductions will be covered in the next chapter.

### Who cannot take the standard deduction?

Some taxpayers cannot take the standard deduction but, instead must itemize their deductions. Be sure to ask the taxpayer if any of these situations were applicable during the tax year:

- Filing status is Married Filing Separately, and their spouse itemizes
- Nonresident, or dual-status alien during the year (and not married to a U.S. citizen or resident at the end of the year)

If either of the above situations applies to the taxpayer, personal deductions must be itemized.

#### example

Chase is married filing separately. Her spouse, Grant, will be itemizing his deductions. Chase cannot use the standard deduction; she will have to itemize her deductions.



**TaxWise Hint:** TaxWise will automatically calculate the standard deduction based on the information collected on the approved intake and interview sheet and subsequently enter it into the Main Information Sheet in TaxWise. If the taxpayer cannot take the standard deduction, TaxWise will prompt the preparer to itemize deductions.

## How does age or blindness affect the standard deduction?

The standard deduction is higher if the taxpayer and/or spouse is 65 or older. It is also higher if one or both are blind. This information is reported in the checkboxes located on page 2 of Form 1040. The more checkboxes marked, the higher the standard deduction. Be sure to verify the taxpayer's and spouse's age and level of blindness as described below.



**TaxWise Hint:** TaxWise will automatically check these boxes based on entries on the Main Information Sheet.

### example

John is 73 years old and blind. He files as Single using Form 1040. At the top of page 2 on line 38, you enter his AGI of \$37,800 from line 37. Because John is over 65 years old and blind, you should enter a "2" on line 39a.

## Who qualifies as 65 or older?

Taxpayers qualify as being 65 or older if they are 65 or older at the end of the year. They are also considered to be 65 on the day before their 65th birthday. Taxpayers are entitled to a higher standard deduction if they are considered 65 or older by the end of the year. In other words, a person born on January 1 of any calendar year is considered to be 65 on December 31 of the previous calendar year. Therefore, the taxpayer can take a higher standard deduction for 2008 if born before January 2, 1944.

The standard deduction for a decedent is the same as if the taxpayer had lived the entire year, with one exception: if the taxpayer died before their 65th birthday, the higher standard deduction for being 65 does not apply to the decedent.

### example

Arnie died on November 24, 2008. He would have been 65 if he had reached his birthday on December 12, 2008. He does not qualify for a higher standard deduction for being 65, even though he was born before January 2, 1944.



## Who qualifies as blind?

A taxpayer must be totally or partially blind on the last day of the year to qualify as blind. Taxpayers are entitled to a higher standard deduction if they are considered totally or partially blind and they do not itemize their deductions. A taxpayer who claims to be partially blind must have a certified statement from an eye doctor or registered optometrist that states either of these conditions:

- The taxpayer cannot see better than 20/200 in the better eye with glasses or contact lenses
- The field of vision is not more than 20 degrees

If the eye condition will never improve beyond these limits, the statement should include that fact. Taxpayers should keep the statement in their records.

## What if only one spouse is over 65 or blind?

Taxpayers can take the higher standard deduction if one spouse is 65 or older, or is blind, and if:

- The taxpayer files a joint return, or
- The taxpayer files a separate return and can claim an exemption for the spouse because the spouse had no gross income and an exemption for the spouse could not be claimed by another taxpayer

### TIP

If vision can be corrected beyond those limits only by contact lenses and the taxpayer can only wear the lenses briefly because of pain, infection, or ulcers, the taxpayer can take the higher standard deduction for blindness.

## What is the standard deduction based on age or blindness?

Standard deduction amounts for taxpayers who are 65 or older, and/or are blind, can be computed using the Standard Deduction Worksheet in the Volunteer Resource Guide (Tab F).



These amounts do not apply if the taxpayer (or spouse if Married Filing Jointly) can be claimed as a dependent on someone else's return.

### example

Rupert is 78. He lost his wife 10 years ago, so he is filing as Single. He is not blind and he cannot be claimed as a dependent on someone else's return. His standard deduction is \$6,800.

### example

Rudy and Ivy are both 76. Ivy is blind. They are filing as Married Filing Jointly. Neither can be claimed as a dependent on someone else's return. Their standard deduction is \$14,050.



## EXERCISES (continued)

Use the Standard Deduction Worksheet in the Volunteer Resource Guide (Tab F) to complete the following exercises. Answers are at the end of the lesson summary.

**Question 3:** Roderick was born December 30, 1944. Does he qualify as being 65 or older? ☐ Yes ☐ No

**Question 4:** Chase and her husband Grant are both over the age of 65 and are legally blind. They will file a joint return and will not itemize their deductions. What is their standard deduction?

- A. \$7,550
- B. \$14,050
- C. \$15,100

**Question 5:** Leticia died July 31, 2008. Her 65th birthday was on September 3, 2008. Does she qualify as age 65? ☐ Yes ☐ No

**Question 6:** Jason was born in 1966. He is single and is considered legally blind. What is his standard deduction?

- A. \$6,800
- B. \$5,450
- C. \$3,000

### What about individuals who can be claimed as dependents?

The standard deduction is generally lower for an individual who can be claimed as a dependent on another person's tax return. The deduction is generally limited to the greater of:

- \$900, or
- The individual's earned income for the year, plus \$300 (but not more than the regular standard deduction amount)

If the dependent taxpayer is 65 or older and/or blind, this calculated standard deduction will be increased by \$1,350 (\$1,050 if married or qualifying widow(er) with dependent child) for each box checked for age or blindness.



**TaxWise Hint:** TaxWise will automatically calculate a dependent's standard deduction, as long as the box indicating that the taxpayer can be claimed as a dependent on another person's tax return has been checked on the Main Information Sheet.

#### example

Janet is single, 22, a full-time student, and not blind. Her parents claimed her as a dependent on their 2008 tax return. She has no itemized deductions, so she will take the standard deduction. She has interest income of \$120 and wages of \$780. Her standard deduction is \$1,080 (\$780+\$300).

### What about individuals who paid real estate taxes but do not itemize?

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For the 2008 tax year, taxpayers who file using the standard deduction will be entitled to an additional standard deduction for paying state and local real property taxes. Single taxpayers will be entitled to a maximum of \$500 and joint taxpayers will be entitled to a maximum of \$1,000.

### How do I determine which deduction to use?

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If taxpayers are not required to itemize, they should take the higher of the standard deduction or the itemized expenses deduction. In general, taxpayers will benefit from itemizing their deductions if they have mortgage interest, qualified charitable contributions, or if unreimbursed medical/dental expenses are large compared to their income. During the interview, ask the taxpayer if any of the following were applicable during the tax year:

- Large out-of-pocket medical and dental expenses
- State and local income taxes, real estate taxes, and/or personal property taxes
- Mortgage interest
- Gifts to charity
- Casualty, theft, and certain other miscellaneous deductions

If the taxpayer's expenses qualify, itemizing may be a better choice.



**TaxWise Hint:** It is easy to compare standard deduction and itemized deductions. TaxWise automatically calculates the taxpayer's standard deduction and displays the amount on line 40 of the Form 1040 screen. From that line, link to Schedule A, Itemized Deductions. Complete the blank fields that apply to the taxpayer's situation. TaxWise calculates the deduction, and automatically selects the deduction method that gives the taxpayer the best result.

### How are taxable income and tax determined?

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Taxable income and tax are determined by using the taxpayer's adjusted gross income, exemption amount, standard deduction or itemized deductions.

## How is taxable income determined?

A taxpayer's taxable income is determined by subtracting certain items from their Adjusted Gross Income (AGI). These include:

- Personal and dependency exemptions, and
- Standard or itemized deductions

### example

Ada is 25 years old and has an adjusted gross income of \$13,000. She is entitled to claim an exemption for herself in the amount of \$3,500 and her filing status is single. She is not considered blind. Her taxable income is \$4,050. (\$13,000 AGI - \$3,500 Exemption - \$5,450 Standard Deduction)



**TaxWise Hint:** TaxWise automatically calculates the exemption amount and displays the result on line 42, applying any limitations.

## How is the tax determined?

Tax is based on the amount of taxable income. There are several methods for finding the tax amount.

- If taxable income is less than \$100,000, use the tax tables
- If taxable income is \$100,000 or more, use the Tax Computation Worksheet

The tax tables are located in the appendix of Publication 4491-W, VITA/TCE Workbook, Publication 17, Your Federal Income Tax for Individuals, and Form 1040 Instructions.



There are rare exceptions in which taxpayers with a taxable income \$100,000 or higher cannot use the Tax Computation Worksheet. See Publication 17, *How to figure your tax*, or Form 1040 Instructions for further information. There are also taxpayers who are subject to the alternative minimum tax (AMT). People who are in these situations are unlikely to seek, or qualify for, volunteer assistance.

### example

Mr. and Mrs. Brown are filing a joint return. Their taxable income is \$25,300. First find the range that includes their income: \$25,300-\$25,350. Then read across to the column that applies to their filing status: Married Filing Jointly. Their tax is \$2,996.



**TaxWise Hint:** Regardless of the taxpayer's situation, figuring the tax is easy with TaxWise. The program has all the information necessary to compute the tax on the return based on previous information that has been input. The program identifies the correct tax amount regardless of the taxable income amount.



If the taxpayer received a qualified dividend or capital gains distribution and you are preparing a paper return, you should figure the individual's total tax using the worksheet in Form 1040 Instructions.

## Practice – Vanessa Franklin

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Take a look at how a volunteer helped our taxpayer, Vanessa Franklin: Go to Appendix A-19 and review the sample interview with Vanessa related to lesson 19.

## Summary

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You should be able to identify those who can take the standard deduction, and how the deduction is affected by their filing status, age, blindness, real estate taxes, and status as a dependent. All of this will make it easier for you to help taxpayers understand how their deduction is computed and its impact on their tax.

You should also understand that the tax computation is based on taxable income. The tax may be further reduced by tax credits to be covered in an upcoming lesson.

You are now ready to work with itemized deductions in the next lesson.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



### EXERCISE ANSWERS

**Answer 1:** A. \$5,450

**Answer 2:** B. \$8,000

**Answer 3:** No. Roderick is only 64. To qualify for the higher standard deduction, his birthday must be before January 2, 1944.

**Answer 4:** C. \$15,100

**Answer 5:** No. Leticia was under 65 when she died in 2008. She does not qualify for the higher standard deduction given to those 65 or older.

**Answer 6:** A. \$6,800



### Introduction

This lesson will assist you in determining if a taxpayer should itemize deductions. Generally, taxpayers should itemize their deductions if their total allowable deductions are higher than the standard deduction amount.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer should itemize deductions
- Determine the deductions that are allowable
- Explain the recordkeeping process for claiming itemized deductions

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4012
- ☐ Publication 4491-W
- ☐ Form 1040
- ☐ Schedule A

### Who must itemize?

Taxpayers who have a standard deduction of zero should itemize their deductions. Taxpayers who normally fall within this category are taxpayers who are:

- Married, filing a separate return, and their spouse is itemizing
- Filing a return for a short tax year due to a change in the annual accounting period
- Considered to be nonresident aliens or dual status aliens during the year

### What are itemized deductions?

Itemized deductions are subtractions from a taxpayer's adjusted gross income (AGI) that reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing deductions. Taxpayers should use the type of deduction that results in the lowest tax.

### How do I decide if a taxpayer should itemize deductions?

In general, taxpayers must have mortgage interest or a very large amount of unreimbursed medical/dental expenses compared to their income to benefit from itemizing their deductions.

If you think the taxpayer may benefit from itemizing, then enter the qualified expenses in TaxWise Schedule A. TaxWise will automatically select the larger of itemized versus standard deduction. You can use the Interview Tips in the Volunteer Resource Guide (Tab F) to help you determine if itemizing deductions would be more beneficial for the taxpayer.

Itemized deductions include amounts paid for qualified:

- Medical and dental expenses
- Certain taxes you paid
- Mortgage interest
- Gifts to charity
- Certain miscellaneous deductions



A married taxpayer, filing separately, whose spouse itemizes deductions is not allowed to claim the standard deduction; if one spouse itemizes, the other must itemize (even if the amount is "0").



**TaxWise Hint:** From line 40 of Form 1040 (Itemized deductions) in the TaxWise tax return, link to Schedule A. Turn to Tab 4, the TaxWise Deductions section of the Volunteer Resource Guide to review.

## How do I handle medical and dental expenses?

Taxpayers must be able to itemize in order to deduct medical and dental expenses. Taxpayers can deduct only the amount of unreimbursed medical and dental expenses that is more than 7.5% of their adjusted gross income (AGI).



If a child of divorced or separated parents is claimed as a dependent on either parent's return, both parents may deduct the medical expenses that they individually paid for the child.



**TaxWise Hint:** From TaxWise Schedule A, line 1, link to the Itemized Deductions Detail Worksheet for a breakdown of medical expenses. See Tab 4 in the Volunteer Resource Guide.

## Which medical and dental expenses are deductible?

### *Whose expenses are covered?*

Qualified medical and dental expenses paid by the taxpayer during the tax year can be included for:

- The taxpayer
- The taxpayer's spouse, and
- Dependents claimed at the time the medical services were provided or at the time the expenses were paid



The standard mileage rate allowed for out-of-pocket expenses for a car when used for medical reasons is 19 cents per mile from 1/1/08 through 6/30/08 and 27 cents per mile from 7/1/08 through 12/31/08.

Review *Whose Medical Expenses Can You Include?* in the Medical and Dental Expenses chapter of Publication 17.

### What types of expenses are covered?

Unreimbursed medical and dental expenses and eligible Long-Term Care premiums paid during the tax year are deductible. Be sure the expenses were not paid with pre-tax dollars or reimbursed by an insurance company.

#### example

Stewart and Carmen are divorced. Their son, Raymond, lives with Carmen, who claims him as a dependent. Carmen paid for and deducted Raymond's standard medical and dental bills, but Stewart deducted the emergency bill he paid when Raymond broke his arm.

#### TIP

If you and a taxpayer disagree as to whether a particular expense is deductible, then politely refer the taxpayer to a professional tax preparer. The taxpayer may be correct, but you should not deduct an expense unless you are sure it is deductible.



### EXERCISES

Answers are at the end of the lesson summary.

**Question 1:** Bill and Kathy Ferris file a joint return. They paid the medical bills listed below. The total of Bill and Kathy's qualified medical expenses is \$\_\_\_\_\_.

Medical Expenses	Amount	Deductible
Unreimbursed doctors' bills	\$500	?
Unreimbursed orthodontist bill for braces	\$1,200	?
Hospital insurance premiums	\$300	?
Life insurance premiums	\$500	?
Unreimbursed prescription medicines	\$100	?
Vitamins	\$70	?
Hospital bill (before insurance company's reimbursement of \$1,000)	\$2,000	?
Smoking-cessation program	\$150	?
<b>Total</b>	<b>\$4,820</b>	<b>?</b>



## How do I handle taxes that may be deductible?

Taxpayers can deduct certain taxes if they itemize their deductions. The taxes that are deductible include the following:

- State, local, or foreign **real estate taxes** based on the assessed value of the taxpayer's real property, such as the taxpayer's house or land
  - To claim the deduction, the taxpayer must be legally liable for the taxes and must pay the taxes during the tax year
  - Real estate taxes are generally found on or with Form 1098, Mortgage Interest Statement, or a similar statement from the mortgage holder. If the taxes are not paid through the mortgage company, the taxpayer should have a record of what they have paid during the year.
- State and local **personal property tax** payments based on the value of personal property, such as a portion of personal vehicle registration, are deductible

### example

Suppose Wayne pays his mother's property taxes. He cannot deduct the tax payments because he was not liable for them. His mother cannot deduct them either because she didn't pay them. However, if Wayne gives the money to his mother, then she can pay the taxes and deduct them.

## Which expenses are not deductible?

Not all taxes are deductible and some items aren't actually classified as taxes. See the Taxes chapter in Publication 17.

## How do I deduct the taxes?

### Income Taxes

If the taxpayer can deduct state and local income taxes on Schedule A, include tax withheld, estimated payments, and tax for an earlier year paid during this tax year. Do *not* include penalties or interest.



State and local tax withheld is sometimes shown on Form W-2 in either box 17 or 19.



**TaxWise Hint:** Tax withheld will carry automatically from Form(s) W-2. If the taxpayer paid state and/or local taxes due from previous years' returns or made estimated payments, include them in TaxWise on the F/S Tax Pd-2008 Federal Estimate/ State Payments worksheet. Link to this worksheet from Schedule A, the right column of line 5.

### Foreign Income Taxes

Generally, income taxes that paid to a foreign country can be taken as an itemized deduction on line 8 of Schedule A (Form 1040, line 40), or as a credit against U.S. income tax on Form 1040, line 50. More information will be provided on this credit in subsequent lessons. You should compare claiming the foreign taxes paid as a nonrefundable credit to taking it as an itemized deduction and use whichever results in the lowest tax.



## EXERCISES (continued)

**Question 2:** Which of the following taxes are deductible on Schedule A?

- A. Federal income tax
- B. State, local, and foreign income tax and real estate tax
- C. Tax on alcohol and tobacco
- D. Foreign sales tax

**Question 3:** For a tax to be deductible, a tax must be \_\_\_\_\_. (Select all that apply.)

- A. Imposed during the tax year
- B. Imposed on the taxpayer
- C. Paid during the tax year
- D. Paid by the taxpayer

## How do I handle interest?

Interest is the amount you pay for the use of borrowed money. Certain types of interest are deductible as itemized deductions. Home mortgage interest, points (paid as a form of interest), and investment interest can be deducted on Schedule A. Investment interest is outside the scope of the volunteer program and should be referred to a professional tax preparer.



Members of the clergy and military can deduct qualified mortgage interest even if they receive a nontaxable housing allowance.

Generally, the taxpayer receives Form 1098, Mortgage Interest Statement, which shows the deductible amount of home mortgage interest paid by the taxpayer. Only taxpayers who are legally liable for the debt can deduct the interest in the year it is paid. Remember that taxpayers may have more than one mortgage or may have refinanced during the year and may have multiple Mortgage Interest Statements. Be sure to include them all.

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0001 <b>2008</b> Form <b>1098</b>		<b>Mortgage Interest Statement</b>
RECIPIENT'S/LENDER'S name, address, and telephone number  		<i>* Caution: The amount shown may not be fully deductible by you. Limits based on the loan amount and the cost and value of the secured property may apply. Also, you may only deduct interest to the extent it was incurred by you, actually paid by you, and not reimbursed by another person.</i>		<b>Copy B For Payer</b>  The information in boxes 1, 2, 3, and 4 is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for this mortgage interest or for these points or because you did not report this refund of interest on your return.
RECIPIENT'S federal identification no.	PAYER'S social security number <b>XXX-00-XXXX</b>	<b>1</b> Mortgage interest received from payer(s)/borrower(s) <sup>1</sup> <b>\$ 3,200</b>		
PAYER'S/BORROWER'S name <b>Ada Purdue</b>		<b>2</b> Points paid on purchase of principal residence \$		
Street address (including apt. no.) <b>1913 Milligan Road</b>		<b>3</b> Refund of overpaid interest \$		
City, state, and ZIP code <b>Gilmer, Alabama 2XXXX</b>		<b>4</b> Mortgage insurance premiums \$		
Account number (see instructions)		<b>5</b>		

Form **1098** (keep for your records) Department of the Treasury - Internal Revenue Service



A taxpayer may be able to deduct interest on a main home AND a second home. A home can be a house, cooperative apartment, condominium, mobile home, house trailer, or houseboat that has sleeping, cooking and toilet facilities.

#### example

From 1991 through 1998, Alfredo and Cindy Kendall borrowed a total of \$91,000 using their home as security. Alfredo and Cindy used the loans to pay off gambling debts, overdue credit payments, and some nondeductible medical expenses.

The total amount of Alfredo and Cindy's secured debt is currently down to \$72,000. The fair market value of their home is \$230,000, and they carry \$30,000 of outstanding acquisition debt (the amount used to buy, build, or improve their home).

If Alfredo and Cindy file a joint return, they can deduct the interest on their loans because:

- The total of these loans (\$91,000) does not exceed \$100,000, and
- The total amount of the secured debt (\$72,000) is not more than the home's fair market value minus any outstanding acquisition debt (\$230,000 - \$30,000 = \$200,000)

#### ***What about points?***

Points are the charges paid by a borrower and/or seller to a lender to secure a loan. They are also called:

- Loan origination fees (including VA and FHA fees)
- Maximum loan charges
- Premium charges
- Loan discount points
- Prepaid interest



Using the flow chart – Is My Home Mortgage Interest Fully Deductible? – in Publication 17 will help you determine if the interest should be included on Schedule A.

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. This interest, even if it qualifies for home mortgage interest, must generally be spread over the life of the mortgage. However, if the loan is used to buy or build a taxpayer's main home, the taxpayer may be able to deduct the entire amount in the year paid. See the Interest Expense chapter of Publication 17 for more information.

Points paid to refinance a mortgage are generally not deductible in full the year the taxpayer paid them, unless the points are paid in connection with the improvement of a main home and certain conditions are met.

#### ***When Are Points Fully Deductible?***

Beware of certain charges that some lenders call points. Points paid for specific services, such as appraisal fees, preparation fees, VA funding fees, or notary fees are *not* interest and are *not* deductible.



Use the flow chart in the Interest Expense chapter of Publication 17 to help you determine if the points are fully deductible.

## Qualified Mortgage Insurance Premiums

Taxpayers can deduct Private Mortgage Insurance (PMI) premiums paid or accrued during the tax year on Line 13 of Form 1040, Schedule A. Private mortgage insurance paid or accrued on a mortgage insurance contract for coverage during 2008 is deductible.

### ***What qualifications are required to deduct PMI?***

- Paid/accrued January 1, 2008 to December 31, 2008
- Borrower bought or refinanced home
- AGI is \$100,000 or less (\$50,000 if Married Filing Separately) – full deduction
- AGI more than \$100K (\$50,000 if Married Filing Separately) – reduced deduction
- AGI more than \$109,000 (\$54,500 if Married Filing Separately) – no deduction

### **What types of interest are *not* deductible?**

Interest that *cannot* be deducted includes:

- Interest on car loans where the car is used for non business purposes
- Other personal loans
- Credit investigation fees
- Loan fees for services needed to get a loan
- Interest on a debt the taxpayer is not legally obligated to pay
- Finance charges for non business credit card purchases



### **EXERCISES** (continued)

**Question 4:** Joe and Angela file a joint return. During the year, they made the interest payments listed below. The total of Joe and Angela's fully deductible interest for the tax year is \$\_\_\_\_\_.

Interest Payments	Amount	Deductible
Qualified interest on their home mortgage, reported on Form 1098	\$2,180	?
Credit card interest	\$400	?
Points paid to refinance their mortgage for a better interest rate (none of the points qualify as interest)	\$1,500	?
Interest on a car loan	\$2,000	?
<b>Total</b>	<b>\$4,880</b>	<b>?</b>

## How do I handle gifts to charity?

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A charitable contribution is a donation or gift to a qualified organization. Taxpayers must itemize their deductions to deduct a charitable contribution. Taxpayers can deduct contributions to **qualifying organizations** that:

- Operate exclusively for religious, charitable, educational, scientific, or literary purposes
- Work to prevent cruelty to children or animals
- Foster national or international amateur sports competition if they do not provide athletic facilities or equipment



The Contributions chapter in Publication 17 provides an easy reference in a table called Examples of Charitable Contributions—A Quick Check.

Deductible items include:

- Monetary donations
- Dues, fees, and assessments paid to qualified organizations above the value of benefits received
- Fair market value of used clothing and furniture
- Cost and upkeep of uniforms that have no general use but must be worn while performing services donated to a charitable organization
- Unreimbursed transportation expenses that relate directly to the services the taxpayer provided for the organization
- Part of a contribution above the fair market value for items received such as merchandise and tickets to charity balls or sporting events
- Transportation expenses, including bus fare, parking fees, tolls, and either the cost of gas and oil or a standard mileage deduction of 14 cents per mile



To be deductible, contributions must be made to a qualifying organization, not an individual.

### Which gifts to charity are *not* deductible?

Organizations that do *not* qualify for deductible contributions include:

- Business organizations, such as the Chamber of Commerce
- Civic leagues and associations
- Political organizations and candidates
- Social clubs
- Foreign organizations
- Homeowners' associations
- Communist organizations

Amounts that may *not* be deducted include:

- Cost of raffle, bingo, or lottery tickets
- Tuition
- Value of a person's time or service
- Blood donated to a blood bank or Red Cross
- Car depreciation, insurance, general repairs, or maintenance
- Direct contributions to an individual

- Sickness or burial expenses for members of a fraternal society
- Part of a contribution that benefits the taxpayer, such as the fair market value of a meal eaten at a charity dinner



**TaxWise Hint:** From TaxWise Schedule A, lines 16 or 17, link to the Itemized Deductions Detail Worksheet for a breakdown of gifts to charity. See Tab 4 in the Volunteer Resource Guide.

#### example

Susan ran a 10K organized by the Chamber of Commerce to benefit a qualified charitable organization. She paid the race organizers a \$30 entry fee and received a “free” t-shirt and pancake breakfast after the race.

Susan did not make a contribution to the qualifying organization. She paid the Chamber of Commerce, which allotted funds to the benefiting organization. Therefore, none of Susan’s entry fee is tax deductible. If the race had been organized by the qualifying organization itself, part of her entry fee may have been deductible.

### What limits apply to charitable deductions?

Taxpayers whose total contributions are more than 20% of their AGI may be able to deduct only a percentage of their contributions, and must carry over the remainder to a later tax year. The percentage varies depending on the type of gift and the type of charitable organization. More information on these limitations is available in Publication 17. Individuals affected by limits on charitable deductions should be referred to a professional tax preparer.



**TaxWise Hint:** Enter amounts given by cash or check under Cash Contributions for 50% Limit Organizations. Enter the value of noncash items donated under Other Than Cash Contributions for 50% Limit Organizations. Even though the TaxWise screen is divided into sections showing different percentages, as long as the taxpayer’s contributions are less than 20% of their AGI, the contribution will *not* be limited. Just be careful to list the Cash Contributions and Other Than Cash Contributions separately.

### What records should the taxpayer keep for charitable contributions?

*Taxpayers must keep records* to prove the amount of the cash and noncash contributions they make during the year. Cash, check, and noncash contributions should be reported on Schedule A, line 16. For each contribution, tell taxpayers that they cannot deduct a cash contribution, regardless of the amount, unless one of the following records of the contribution is kept:

- A bank record, such as a canceled check, a bank copy of a canceled check, or a bank statement containing the name of the charity, the date, and the amount
- A written communication from the charity, which must include the name of the charity, date of the contribution, and amount of the contribution

### ***Out-of-Pocket Expenses***

For unreimbursed expenses related to donated services, the taxpayer must have:

- Adequate records of the expenses
- Organization's written acknowledgement and description of the taxpayer's services

Only out-of-pocket expenses that are directly related to the donated services can be deducted. The value of time or services donated cannot be deducted.

### **What records should the taxpayer keep for noncash contributions?**

#### ***Noncash Contribution Deductions Less Than \$250***

For each single contribution of less than \$250, tell the taxpayer to keep:

- Receipt or other written communication from the organization or the taxpayer's own reliable written records for each item, showing:
  - Name and address of organization
  - Date and location of the contribution
  - Reasonably detailed description of the donated property
  - Fair market value of the donated property



Effective for contributions made after August 17, 2006, deductions are disallowed for the charitable contribution of clothing and household items if the items are not in good used condition or better.



If the taxpayer is reducing the fair market value by appreciation, or donating capital gain property, refer the taxpayer to a professional tax preparer.

#### ***Noncash Contribution Deductions of At Least \$250 but Not More Than \$500***

For each single contribution of at least \$250 and not more than \$500, the taxpayer must have all the documentation described for noncash contributions less than \$250. In addition, the organization's written acknowledgement must state whether the taxpayer received any goods or services in return and a description and good faith estimate of any such items.

#### ***Noncash Contribution Deductions of More Than \$500***

Taxpayers with noncash contributions exceeding \$500 should be referred to a professional tax preparer.



### **EXERCISES** (continued)

**Question 5:** Julia made the following contributions last year:

- \$600 to St. Martin's Church (the church gave her a letter verifying the amount)
- \$32 to Girl Scouts (not for cookies!)
- \$40 to a family whose house burned
- \$50 for lottery tickets at a fundraiser
- \$100 for playing bingo at her church

The amount that Julia can claim as deductible monetary contributions is \$\_\_\_\_\_.



## What are casualty and theft losses?

---

The deduction for casualty and theft losses is complex, with many rules and exceptions, so you should refer the taxpayer to a professional tax preparer.

### Miscellaneous Deductions

#### ***What types of miscellaneous expenses are deductible?***

Miscellaneous itemized deductions are expenses a taxpayer pays in order to:

- Produce or collect income
- Manage, conserve, or maintain property held for producing income
- Determine, contest, pay, or claim a refund of any tax

For some miscellaneous deductions, only the portion that exceeds 2% of the taxpayer's AGI can be deducted. Other miscellaneous deductions are deductible regardless of AGI.

#### ***Which deductions are subject to the 2% limit?***

Deductions subject to the 2% limit are reported on lines 21 through 27 of Schedule A. Examples include:

- Union dues and fees
- Professional society dues
- Uniforms not adaptable to general use (See the Miscellaneous Deductions chapter in Publication 17 for a discussion)
- Small tools and supplies
- Professional books, magazines, and journals
- Employment-related educational expenses (See Publication 17 for the Does Your Work-Related Education Qualify? in the chapter Tax Benefits for Work-Related Education)
- Expenses of looking for a new job in your present occupation
- Investment counsel fees
- Investment expenses
- Safe deposit box rental for investment documents
- Tax counsel and assistance
- Fees paid to an IRA custodian

#### ***Which deductions are exempt from the 2% limit?***

Deductions that are *not* subject to the 2% limit are reported on line 28 of Schedule A. Examples include:

- Gambling losses to the extent of gambling winnings (taxpayer must have kept a record of their losses)
- Work-related expenses for individuals with a disability that enable them to work, such as attendant care services at their workplace



Claiming gambling losses in excess of winnings is beyond the scope of the VITA/TCE program. Refer these taxpayers to a professional tax preparer.



## What types of miscellaneous expenses are not deductible?

The types of miscellaneous expenses that are not deductible include:

- Political contributions
- The cost of entertaining friends
- Lost or misplaced cash or property
- Travel as a form of education



An attorney fee for a will is considered a personal legal expense, so it is not deductible.



### EXERCISES (continued)

**Question 6:** Philip had the expenses shown below. What is the total of Philip's qualified miscellaneous itemized expenses? \$\_\_\_\_\_.

Expense	Amount	Deductible
Income tax preparation fee	\$100	?
Safe deposit box rental (to store bonds)	\$75	?
Life insurance premiums	\$300	?
Investment expenses	\$70	?
Loss on sale of personal home	\$1,800	?
Investment journals and newsletters	\$250	?
Investment advisory fees	\$200	?
Attorney fees for preparation of a will	\$100	?
<b>Total</b>	<b>\$2,895</b>	<b>?</b>

## Practice - Vanessa Franklin



Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-20 and review the sample interviews with Vanessa related to Lesson 20.

Return to this lesson after you have reviewed this information.

## Summary

### Medical and Dental Expenses

Deductible medical and dental expenses are reported and calculated on lines 1 through 4 of Schedule A. From TaxWise Schedule A, link to the Itemized Deductions Detail Worksheet for a breakdown of medical expenses.

Qualified medical and dental expenses are those the taxpayer paid during the tax year for the taxpayer, spouse, and dependents.

## Taxes

Deductible taxes are reported on lines 5 through 9 of Schedule A. Taxpayers can deduct the following:

- State and local income taxes
- State, local, or foreign **real estate taxes**
- State and local **personal property tax** payments

## Interest

Deductible interest is reported on lines 10 through 15 of Schedule A.

Generally, the taxpayer receives Form 1098, Mortgage Interest Statement, which shows the deductible amount of interest paid by the taxpayer. To be deductible, the interest must be paid by the taxpayer during the tax year. Only taxpayers who are legally liable for the debt can deduct the interest.

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. This interest, even if it qualifies for home mortgage interest, must generally be spread over the life of the mortgage. However, if the loan is used to buy or build a taxpayer's main home, the taxpayer may be able to deduct the entire amount in the year paid. See Publication 17 for more information.

Points paid to refinance a mortgage are generally not deductible in full the year the taxpayer paid them, unless the points are paid in connection with the improvement of a main home and certain conditions are met.

## Gifts to Charity

Qualified charitable contributions are reported on lines 16 through 19 of Schedule A.

The contributions to **qualifying organizations** that taxpayers can deduct include:

- Monetary donations
- Dues, fees, and assessments paid to qualified organizations above the value of benefits received
- Fair market value of used clothing and furniture
- Cost and upkeep of uniforms that have no general use but must be worn while performing donated services for a charitable organization
- Unreimbursed transportation expenses that relate directly to the services the taxpayer provided for the qualifying organization
- Part of a contribution above the fair market value for items received such as merchandise and tickets to charity balls or sporting events

*Taxpayers are required to keep receipts and records of all their contributions.*

## Miscellaneous Deductions

For some miscellaneous deductions, only the portion that exceeds 2% of the taxpayer's AGI can be deducted. Other miscellaneous deductions are deductible regardless of AGI. See Publication 17 for the chapter on Miscellaneous Deductions not subject to the 2% limitation.



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Intermediate - Yale
2. Advanced - Dalhart
3. Military - Sierra
4. International - Holmes



## EXERCISE ANSWERS

**Answer 1:** The total of qualified medical and dental expenses is \$3,250, which does not include life insurance premiums, vitamins, or reimbursed hospital expenses.

**Answer 2:** B. State, local, foreign income tax, and real estate taxes are all deductible on Schedule A.

**Answer 3:** B, C, and D. Taxpayers cannot deduct a tax they did not owe, did not pay, or that they paid during another year. However, the tax may have been imposed in a prior year.

**Answer 4:** \$2,180. The only interest that is fully deductible for the tax year is Joe and Angela's home mortgage interest. The points they paid to refinance are not deductible in full for the tax year, and the other interest paid was personal interest and is not deductible.

**Answer 5:** The amount that Julia can claim as deductible cash contributions is \$632 (donations to her church and to the Girl Scouts). Bingo, lottery tickets, and donations to individuals in need are not deductible.

**Answer 6:** \$695, which includes tax preparation fee, safe deposit box rental, investment expenses, investment journals and newsletters, and investment advisory fees.



### Introduction

This lesson will help you determine and claim qualified employee business expenses for members of the Armed Forces, such as uniforms, education and travel that are related to working as a member of the Armed Forces. These expenses, with one exception, may be reported on Form 2106 and will be deducted on Schedule A as a Miscellaneous Itemized Deduction subject to the 2% limit.

#### TIP

Although the approved intake and interview sheet does not list military employee business expenses, it is important to ensure that service members take advantage of deductions to which they are entitled. Ask taxpayers if they had any unreimbursed military work-related expenses.

### Objectives

At the end of this lesson, using your resource tools, you will be able to:

- Determine if the taxpayer has military business expenses that can be deducted
- Identify which form to use to report military business expenses

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 3
- ☐ Publication 4491-W
- ☐ Form 2106
- ☐ Schedule A

#### Optional:

- ☐ Publication 463
- ☐ Publication 970
- ☐ Form 2106 Instructions

### What are military employee business expenses?

Military employee business expenses are necessary business-related expenses incurred by active members of the U.S. Armed Forces. The U.S. Armed Forces includes commissioned officers, warrant officers, and enlisted personnel in all regular and reserve units under the control of the Secretaries of the Defense, Army, Navy, Air Force, and Coast Guard. It does not include members of the Merchant Marines or the American Red Cross.

### What are qualified uniform expenses?

Qualified uniform expenses are the cost and upkeep of uniforms and certain articles that are:

- Specifically required as a condition of employment, and
- Not adaptable to general use as regular clothing

For example, although members of the Armed Forces are required to wear uniforms when they are on duty, they are generally allowed to wear their uniforms in place of regular civilian clothing when they are off duty. Therefore, in this case, members of the military cannot claim a deduction for the uniform cost and upkeep.

However, when military regulations *prohibit* off-duty wear of certain uniforms, service members can deduct the cost and upkeep of those uniforms. Service members must reduce the deductible expenses by any nontaxable uniform allowance or reimbursement they receive.

In addition, required items that do not replace regular clothing, such as insignia of rank, corps devices, epaulets, aiguillettes, and swords, can be deducted.



The same rules apply for active duty personnel and reservists.

### Are professional dues deductible?

Professional dues paid to professional societies that are directly related to their trade or business can be deducted by service members.

However, service members cannot deduct amounts paid to an officers' club or a noncommissioned officers' club.

#### example

Lt. Margaret Allen, an electrical engineer at Maxwell Air Force Base, can deduct professional dues paid to the American Society of Electrical Engineers.



### EXERCISES

Answers are after the lesson summary.

**Question 1:** Which of the following expenses can be deducted?

- A. The cost of a dress blue uniform (without shoulder boards or gold stripe on pants), including cape; off-duty wear allowed
- B. The cost of a full Army green uniform (without braid) that can be worn anytime
- C. The cost of battle dress uniforms and utility uniforms that can be worn only while on duty or while traveling to and from duty
- D. None of the above

**Question 2:** Which of the following expenses can be deducted?

- A. Cost of epaulets
- B. Cost and upkeep of a reservist's uniform that can be worn off duty (no uniform allowance received)
- C. All of the above

**Question 3:** Lt. Clement Clay is on active duty for the U.S. Navy. He specializes in the installation and maintenance of sonar detection systems on Navy ships. As a volunteer, he also draws illustrations and cartoons for his base's internal newsletter. He receives no compensation for his illustrations. Is the membership fee he pays to the Professional Illustrators' Society a deductible expense? ☐ Yes ☐ No

## Can service members claim work-related educational expenses?

Service members can claim educational expenses as an employee business expense if the education:

- Is required by their employer, the law, or regulations to keep their current salary, status, or job (if these requirements serve a business purpose of the employer); or
- Maintains or improves the skills required in the taxpayer's present work

These expenses are deductible whether or not the education may lead to a degree.

However, service members cannot claim an employee business expense for education that is:

- Needed to meet the minimum educational requirements for their trade or business, or
- Part of a program of study that will qualify them for a new trade or business

### TIP

This section relates only to expenses that may be deductible on Schedule A subject to the 2% AGI limitation. Taxpayers can determine whether the expenses also qualify as an education credit, then claim them where they are most beneficial.

### example

Sgt. Vance Ventura, an Army pilot, incurred educational expenses to obtain an accounting degree. He cannot deduct his accounting degree expenses on Schedule A because the degree will qualify him for a new trade or business.



### EXERCISES (continued)

**Question 4:** True or False? For educational expenses to be claimed as an employee business expense deduction, the education must help the taxpayer qualify for a degree.

☐ True ☐ False

**Question 5:** Which of the following can be classified as a work-related education expense?

- A. Cost of a laptop and desk lamp for studying
- B. Expenses incurred by a flight operations officer to take an advanced piloting course
- C. Cost of civilian clothes to wear to a course taken off base
- D. Expenses incurred by a Navy disbursing clerk to learn television repair

## What about travel and transportation expenses incurred for educational expenses?

Service members who have qualified deductible educational expenses may deduct the cost of travel and transportation for that education. This includes the cost of going from work to school, or travel expenses if the taxpayer travels overnight mainly to obtain work-related education. The taxpayer cannot deduct the round-trip cost of going

from home to school unless the taxpayer is regularly employed and goes to school on a temporary basis (not reasonably expected to last more than one year) for work-related education.



See Publication 970 for additional information regarding Educational Expenses.



Taxpayers cannot deduct the cost of travel that is itself a form of education, even if it is directly related to their duties.



## EXERCISES (continued)

**Question 6:** Major Lindsey Manchester is stationed in Manila. On weekends, she drives to Taal to take lessons in traditional Philippine dance. Can Major Manchester deduct these travel expenses? ☐ Yes ☐ No

## What are travel expenses?

Travel expenses are unreimbursed work-related expenses incurred while service members are traveling away from home. They must be ordinary and necessary expenses such as airfare, car rental, taxi fare, lodging, meals, etc. Expenses for personal travel, leave, or liberty cannot be deducted.

## When are travel expenses deductible?

For travel expenses to be deductible:

- There must be a work-related purpose for the travel
- They must be deemed as the “ordinary and necessary” costs of traveling away from home
- The expenses must be greater than the total of any advances, allowances, and/or reimbursements service members received



If Armed Forces members do not claim reimbursement for expenses they are entitled to, no deduction for those expenses may be claimed.

## What is meant by “away from home”?

“Away from home” has a slightly different meaning for military than for nonmilitary taxpayers. For service members, “home” is the duty station to which they are permanently assigned (which can be a ship or a base). It includes the entire city or general area where the post of duty is located.

Service personnel are considered to be away from home if they are away from their permanent duty stations for a period substantially longer than an ordinary day’s work. Service members may deduct business-related travel expenses incurred while traveling away from home.



For Navy personnel assigned to permanent duty aboard a ship that has regular eating and living facilities, the ship is considered to be “home” for travel expense purposes.

Examples of work-related travel expenses for members of the Armed Forces include:

- Expenses incurred while on temporary duty (**TDY**) or temporary additional duty (**TAD**) if away from home (ship, base, or station)
- Expenses of a reservist away from home overnight to attend drills
- Meals and lodging of a reservist temporarily called to active duty
- Travel expenses, including meals and lodging, incurred in connection with deductible educational activities
- Travel expenses incurred when carrying on official business while on “no cost” (to the government) orders



## **EXERCISES** (continued)

**Question 7:** Which of the following individuals is entitled to deduct travel expenses?

- A. Sgt. Bullock, who commutes from his home to his permanent post of duty in the same city
- B. Capt. Hinds, who takes a taxi to work from his home to his permanent post of duty
- C. Major Forrest, a reservist who is called to temporary duty and must attend an overnight meeting away from home
- D. PFC Jenkins, who is assigned to permanent duty aboard a ship that provides meals and lodging

### **What are temporary active duty reservists' expenses?**

Military reservists temporarily called to active duty who must remain away from home to perform their duties may claim unreimbursed travel expenses such as meals and lodging. This applies:

- As long as the duty occurred under competent orders, and
- Whether or not the reservist was compensated

To claim unreimbursed travel expenses, reservists must:

- Be stationed away from the general area of their job or business
- Return to their regular jobs once released

Expenses are deductible only if the reservists pay for meals and lodging at their official military post and only to the extent the expenses exceed Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS).



## What is the 100 mile rule?

Military reservists who must travel more than 100 miles away from home and stay overnight to attend a drill or reserve meeting may be able to deduct their travel expenses as an adjustment to income rather than as a miscellaneous itemized deduction. The amount of expenses that can be deducted is limited to the:

- Federal rate for per diem (for lodging, meals, and incidental expenses)
- Standard mileage rate (for car expenses) plus any parking fees, ferry fees, and/or tolls

Any expense in excess of these rates and expenses that do not qualify for the adjustment to gross income deduction can be claimed only as a miscellaneous itemized deduction subject to the 2% limit.

## 2008 Mileage Rates

Purpose	Cents per Mile Rates 1/1/08- 6/30/08	Cents per Mile Rates 7/1/08- 12/31/08
Business	50.5	58.5



**TaxWise Hint:** On the TaxWise entry screen for Form 2106 page 1, there is a box at the bottom for “Minister, QPA, FBO, RC, and Impairment Related Work Expenses.” On the line to the right of RC, enter the portion of the amount from Line 10 of Form 2106 that is due to reservist travel expenses over 100 miles. You can link from the entry field to a scratch pad to add up the separate items (vehicle expenses, lodging and 50% of food) if you wish. TaxWise will carry the “RC” reservist expenses to line 24 on the front of Form 1040, and the remainder to line 21 of Schedule A.



Military Reservists include members of the U.S. Armed Forces (Army, Navy, Marine Corps, Air Force, Coast Guard Reserve), the U.S. Army National Guard; the U.S. Air National Guard; or the Reserve Corps of the U.S. Public Health Service.

### example

Mary is in the Army Reserve. She lives in a town that is 120 miles from Base A, where she normally reports for Reserve drills or meetings. During 2008, she also occasionally traveled to Base B, which was only 40 miles from her home.

Mary may claim the travel expenses she incurred going to Base A as an adjustment to income. Mary’s remaining expenses for travel to Base B may qualify as an itemized deduction on line 20 of Schedule A (Form 1040). This deduction will be subject to the 2% AGI limitation.

## What is the deduction for meals?

U.S. service personnel can deduct the cost of meals and business-related entertainment incurred during business travel away from their permanent duty station. The deduction for meals is generally limited to 50% of the actual expenses.

For service personnel who are fully reimbursed by the government for meals under an accountable plan that excludes reimbursement from gross income, there is no amount to deduct and, therefore, no amount subject to the 50% limit.

For information on using the standard meal allowance instead of actual expenses, see Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

## What are local transportation expenses?

Local transportation expenses are typically defined as the ordinary and necessary costs incurred in getting from one place to another to perform work-related duties while *not* traveling away from home. This can include traveling from one job to another. However, the expenses of getting to and from your regular place of work are not deductible.

Allowable local transportation expenses include:

- The cost of driving and maintaining one's own vehicle
- Travel by rental cars, bus, rail, and/or taxi

### Are car expenses deductible?

Service personnel who use their own vehicles to travel for work are entitled to deduct actual expenses or the standard mileage rate to figure the deductible costs of operating their vehicles for business purposes.

#### TIP

The standard mileage rate can be found on Form 2106, Part II, Section B, and Form 2106-EZ, Part II.

Actual expenses include the cost of gas, oil, repairs, insurance, and depreciation on the vehicle. If a taxpayer desires to use actual expenses instead of the standard mileage rate, refer them to a professional tax preparer.



### EXERCISES (continued)

**Question 8:** Which of the following costs are considered to be a local transportation expense?

- A. Daily meals taken during a week-long training session while on duty
- B. Gasoline used to drive to and from one's regular place of work
- C. Taxi fare to travel to a local work-related convention on a work-related topic, while on duty
- D. Elaborate lunch to treat top-ranking military official visiting base

## Are expenses related to temporary work locations deductible?

Expenses incurred while commuting to work are not deductible. However, service members who are assigned to temporary assignments in the same trade or business as their regular place of business can deduct the expenses of the daily round trip between their home and the temporary location, if not reimbursed by their employer.

Service members can deduct ordinary and necessary costs of traveling to temporary work assignments:

- Traveling from one workplace to another within the city or general area that is their tax home
- Visiting clients or customers
- Going to a business meeting away from their regular workplace

Expenses incurred while traveling away from home overnight are deductible as travel expenses, not local transportation expenses.

### example

Sgt. Manuel Purdue attended a meeting of an Armed Forces reserve unit. The meeting is considered to be a second place of business because it is held on one of Sgt. Purdue's regular work days. He can deduct the expense of traveling from his home and regular work location to the meeting location.

## Who needs to complete Form 2106?

If the service member has job-related travel, meals, or local transportation expenses, or other expenses that are greater than reimbursements, Form 2106 must be used to calculate the itemized deduction.

Form 2106 is not required if the taxpayer is claiming only job-related expenses for uniforms, professional dues or education, and no reimbursement was received.

To determine whether service members need to complete Form 2106, consider the following factors:

- Did the service member have work-related travel, meals, or local transportation expenses?
- Did the service member receive an allowance or reimbursement from the military?
- Did the amount of travel expenses exceed the amount of the reimbursement or allowance?

For service members who are not required to file Form 2106, enter miscellaneous deductions subject to 2% of AGI directly on Schedule A, line 21.

### TIP

2106-EZ can only be used by employees who received no reimbursement from their employer and who use the standard mileage rate. In most cases, military members with work-related travel expenses will have received reimbursement and will need to use Form 2106.

### example

Capt. Glendale traveled from his duty station in California to Washington, DC, for a conference. He was away for five days. The Army advanced \$700 to Capt. Glendale for the trip. His actual expenses were \$625. When he filed his travel voucher with the Army, he returned the extra \$75. He does not have to complete Form 2106.

## How do I complete Form 2106?

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Use Form 2106, Employee Business Expense, to calculate business and job-related deductions.

Form 2106 is divided into two parts. Part I addresses total travel expenses; Part II specifically covers vehicle expenses.

If the service member incurred a vehicle expense for work-related travel, complete Part II before entering an amount in line 1 of Part 1:

- Section A requests general information about vehicle use. The “placed in service” date is the date the taxpayer began using the vehicle for business.
- Section B (line 22) is for taxpayers who choose to use the standard mileage rate for the vehicle.



**TaxWise Hint:** Once you enter the total mileage on line 13 of Form 2106, TaxWise will apply the standard mileage rate and carry the amount to lines 1 and 22 of the form. You can link to a scratch pad from line 13 if you need to add up mileage amounts.

- Sections C and D are for taxpayers who are using the actual expense method to calculate their vehicle expenses. This is beyond the scope of the volunteer program – refer to a paid preparer.

Part I, on the first page of Form 2106, is divided into 3 steps:

- Use Step 1 to summarize overall expenses.
  - Use Column A for all expenses other than meals and entertainment.
  - Use Column B only for meals and entertainment expenses.
  - Enter other job-related expenses, such as uniforms, educational expenses, and professional dues on line 4.
- Complete Step 2 only if the taxpayer was reimbursed and the reimbursement is not shown as income to the taxpayer on Form W-2 or Form 1099.
- Complete Step 3 when the employer did not reimburse the employee in full. Line 10 of this section shows the amount of the deduction that can be claimed on Schedule A, Form 1040. This amount may be reduced when you apply the 2% AGI limit.

### TIP

If preparing a paper return which includes Form 2106, Form 2106 instructions are very helpful.

Once you have completed Form 2106, enter the amount from line 10 onto line 21 of Schedule A, Form 1040.

## Taxpayer Example

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Let's see how a volunteer helps Mary, the Army Reservist, determine how to deduct her employee business expenses:

## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*You were in the Reserves, as well as working your full-time civilian job. Did you have any expenses associated with that?*

*Oh, good. The expenses you have for traveling more than 100 miles as a reservist can be deducted, even if you can't itemize. Did you have to pay for lodging or meals or parking?*

*Did you get any reimbursement?*

*The most we'll be able to deduct on the meals is 50%, but you can take all of the lodging, plus your mileage. It's different for the drills at the other base, since they're not as far. Did you leave from your regular job to go to that base, or would it be on a day off?*

*Since you are driving from one job to another, that's deductible too. But only if you can itemize, and it's over 2% of your AGI. Did you have any other work-related expenses?*

*Did you get reimbursed for any part of that?*

*Then you'll be able to deduct the \$100 you paid out of pocket – but only if you can itemize and beat that 2% limit.*

*All right, the expenses for traveling more than 100 miles for reserve duties adds up to \$1091, along with the hotel rooms at \$648, and half the meals at \$90 totals \$1,829 – we'll deduct that right on the front of the return. The other mileage from trips to Baker add up to \$162 and the \$100 out of pocket for the class will give us a total of \$262 for your Schedule A if you can itemize. Now let me ask you some questions about your car so I can complete this form...*

*[On Mary's approved intake and interview sheet, indicate that you've addressed these items.]*

### MARY RESPONDS...

Well, my unit usually meets at Anderson, which is about 120 miles from here. I had nine round trips during the first six months of 2008, plus we met at Baker four times. That's only 40 miles away. Here's my mileage record.

I paid \$72 for a hotel room each time, and I ate at the mess for about \$20 each trip.

No, I have to pay for it myself.

No, those were short meetings on week-nights, so I would just drive straight from work.

I'm a trauma nurse, and I have to take continuing education courses each year to stay certified. The classes cost \$500 once I paid for the books.

The military gives me an allowance, but that only covered \$400.



**Employee Business Expenses****2008**Department of the Treasury  
Internal Revenue Service (99)

▶ See separate instructions.

▶ Attach to Form 1040 or Form 1040NR.

Attachment  
Sequence No. **54**

Your name

Occupation in which you incurred expenses

Social security number

**Part I Employee Business Expenses and Reimbursements**

Step 1 Enter Your Expenses		Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1	Vehicle expense from line 22c or line 29. (Rural mail carriers: See instructions.)	1,253 00	
2	Parking fees, tolls, and transportation, including train, bus, etc., that <b>did not</b> involve overnight travel or commuting to and from work		
3	Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Do not</b> include meals and entertainment	648 00	
4	Business expenses not included on lines 1 through 3. <b>Do not</b> include meals and entertainment.	500 00	
5	Meals and entertainment expenses (see instructions)		180 00
6	<b>Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5	2,401 00	180 00

**Note:** If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.**Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1**

7	Enter reimbursements received from your employer that were <b>not</b> reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions)	400 00	
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**Step 3 Figure Expenses To Deduct on Schedule A (Form 1040 or Form 1040NR)**

8	Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 (or on Form 1040NR, line 8)	2,001 00	180 00
9	In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 80% (.80) instead of 50%. For details, see instructions.)	2,001 00	90 00
10	Add the amounts on line 9 of both columns and enter the total here. <b>Also, enter the total on Schedule A (Form 1040), line 21 (or on Schedule A (Form 1040NR), line 9).</b> (Reservists, qualified performing artists, fee-basis state or local government officials, and individuals with disabilities: See the instructions for special rules on where to enter the total.)		2,091 00

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 11700N

Form **2106** (2008)

**Part II Vehicle Expenses****Section A—General Information** (You must complete this section if you are claiming vehicle expenses.)

	(a) Vehicle 1	(b) Vehicle 2
<b>11</b> Enter the date the vehicle was placed in service . . . . .	<b>11</b> 03 / 15 / 2007	/ /
<b>12</b> Total miles the vehicle was driven during 2008 . . . . .	<b>12</b> 10,000 miles	miles
<b>13</b> Business miles included on line 12 . . . . .	<b>13</b> 2,480 miles	miles
<b>14</b> Percent of business use. Divide line 13 by line 12 . . . . .	<b>14</b> 25 %	%
<b>15</b> Average daily roundtrip commuting distance . . . . .	<b>15</b> 10 miles	miles
<b>16</b> Commuting miles included on line 12 . . . . .	<b>16</b> 5,000 miles	miles
<b>17</b> Other miles. Add lines 13 and 16 and subtract the total from line 12. . . . .	<b>17</b> 2,520 miles	miles
<b>18</b> Was your vehicle available for personal use during off-duty hours? . . . . .	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>19</b> Do you (or your spouse) have another vehicle available for personal use? . . . . .	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>20</b> Do you have evidence to support your deduction? . . . . .	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>21</b> If "Yes," is the evidence written? . . . . .	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

**Section B—Standard Mileage Rate** (See the instructions for Part II to find out whether to complete this section or Section C.)

<b>22a</b> Multiply business miles driven <b>before</b> July 1, 2008, by 50.5¢ (.505) . . . . .	<b>22a</b>	
<b>b</b> Multiply business miles driven <b>after</b> June 30, 2008, by 58.5¢ (.585) . . . . .	<b>22b</b>	
<b>c</b> Add lines 22a and 22b. Enter the result here and on line 1 . . . . .	<b>22c</b>	

Of the \$2091 on line 10 of Form 2106, \$1829 will be entered on line 24 of Form 1040 and the remaining \$262 will be entered on Schedule A.

## Summary

This lesson explained itemized deductions of special interest to the military and how to claim them.

Travel expenses must be ordinary and necessary expenses of temporarily traveling away from home for a person's job and must be greater than the total of any advances, allowances, and reimbursements received for such expenses.

- Travel and transportation expenses can be taken as miscellaneous itemized deductions on Schedule A, subject to the 2% AGI limit.
- Travel expenses for meals, lodging, and incidentals are only deductible if they are incurred while temporarily away from home on business. Assignments that last, or are realistically expected to last, more than one year are not considered temporary.
- Commuting and other personal expenses are not deductible.
- Travel costs associated with deductible educational expenses are treated like other business travel costs.

Form 2106 and Schedule A Form 1040 are used to figure and claim the itemized deduction for employee business expenses that exceed reimbursement. Taxpayers are required to file Form 2106 to claim job-related travel, transportation, meals, or entertainment expenses, or when they have been paid by their employer for any expenses being deducted on Schedule A, line 21.

National Guard and Reserve members who travel more than 100 miles away from home and stay overnight to attend drill or reserve meetings can deduct travel expenses as an adjustment to income. All other deductible miscellaneous itemized deductions discussed in this lesson are deducted on Schedule A as a Miscellaneous Itemized Deduction, subject to the 2% AGI limit.

To claim these expenses, a taxpayer must itemize using Schedule A (Form 1040) Itemized Deductions.



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Military - Sierra



## EXERCISE ANSWERS

**Answer 1:** C. The cost of battle dress uniforms and utility uniforms that can be worn only while on duty or while traveling to and from duty.

**Answer 2:** A. The cost of items not replacing regular clothing such as insignia of rank and epaulets are deductible.

**Answer 3:** No. Lt. Clement Clay's illustrations are not part of his official duties, and cannot be deducted as an employee business expense.

**Answer 4:** False. The education does not have to lead to a degree as long as it helps maintain or improve skills or knowledge needed for the taxpayer's current job.

**Answer 5:** B. Educational expenses may be claimed as miscellaneous itemized deductions if the education improves the skills used in the taxpayer's current job.

**Answer 6:** No. Major Manchester cannot deduct the cost of traveling to Taal on weekends because the travel is not work-related.

**Answer 7:** C. Only Major Forrest can deduct the costs of traveling overnight to attend a reservists' meeting.

**Answer 8:** C. Taxi fare to travel on work-related business while not away from home is an allowable local transportation expense.



## This image shows a full page of a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page, providing a guide for writing. There are no margins, text, or other markings on the paper.



### Introduction

This lesson provides information on deducting the ordinary and necessary business-related expenses a taxpayer may have for travel entertainment, gifts, or transportation. An ordinary expense is one that is common and accepted in the taxpayer's field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for a taxpayer's business.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Compute business-related travel deductions
- Determine if a taxpayer must file Form 2106

### What qualifies as a deductible business travel expense?

Deductible travel expenses include ordinary and necessary business expenses for your job. These are expenses that a taxpayer incurs *while conducting business* and cannot include any personal expenses incurred for family members or expenses such as sightseeing or non-business entertainment.

Examples of deductible business travel expenses include:

- Fares for taxis, trains, airplanes, etc.
- Rental car expenses
- Costs of operating and maintaining an automobile
- Baggage charges
- Meals and lodging
- Cleaning and laundry expenses
- Telephone expenses
- Tips and gratuities
- Other necessary and ordinary expenses related to travel

Lodging and transportation connected with overnight travel away from one's tax home are deductible, but the expense of commuting to and from work is not considered a business travel expense.

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Form 1040
- ☐ Form 2106
- ☐ Form 2106 Instructions
- ☐ Form 2106-EZ
- ☐ Schedule A
- ☐ **Optional:** Publication 463

## What is considered a taxpayer's tax home?

A taxpayer's "tax home" is defined in general as his or her regular or main place of business or post of duty, regardless of where the taxpayer's family resides. One cannot deduct expenses for travel away from one's tax home for any period of temporary employment of more than one year.

## Who is eligible for home leave?

Section 903 of the Foreign Service Act of 1980 provides that the head of a foreign affairs agency may order a member of the Foreign Service who is a citizen of the United States to take home leave upon completion of 18 months of continuous service abroad, and shall so order as soon as possible after completion of three years of continuous service abroad. Because members of the Foreign Service are required by law to take a leave of absence, they are allowed to deduct amounts paid for travel, meals, and lodging while on home leave as employee business expenses. The taxpayers who are eligible for this leave will deduct these expenses on Form 2106, Employee Business Expenses, just like an employee who is conducting business away from home. As with all deductible employee business expenses, records and receipts must be maintained to support the deductions that are taken. Any expenses paid for on behalf of a Foreign Service member's family are personal expenses and therefore are not deductible.



United States Foreign Service employees who are on mandatory "home leave" are allowed to deduct amounts paid for travel, meals, and lodging while on home leave. However, amounts paid on behalf of the taxpayer's family while on home leave are personal living expenses and are not deductible.

### example

Jocelyn Lane's permanent duty station for the U.S. Foreign Service is in Korea. Her husband and children could not accompany her and have remained at their home in the United States. After two years of continuous duty, she comes back to the United States for five weeks of mandatory home leave. She can deduct the cost of her transportation, lodging, and meals while traveling home. She can also deduct her meals and transportation once she is home on leave, and her transportation, lodging, and meals while traveling back to her office in Korea.

## Are reimbursements reported?

Taxpayers must report both business travel expenses as well as any employer-provided reimbursement. In some cases, this results in a net expense of zero. In other cases, excess reimbursements may be taxable income. When taxpayers combine personal and business travel, they must strictly separate the expenses.

### example

Bob Smith traveled to a conference in Cleveland, Ohio that lasted from Wednesday through Friday. His employer reimbursed him for his transportation to and from the conference, his rental car expenses, and his meals. He postponed his travel home until Sunday afternoon so he could visit a luxury spa in Coshocton, Ohio. He may report the expenses for the conference and the reimbursement, but he cannot claim any costs related to visiting the spa.

## What records must the taxpayer have?

Taxpayers must keep records in order to deduct travel expenses, which include meals (unless using the standard meal allowance), entertainment, gifts, or use of an automobile or other listed property. The records must document the time, place, business purpose, business relationship (for entertainment and gifts), and amounts of each expense. Generally, taxpayers must have receipts for all lodging expenses, regardless of the amount, and for any other expenses of \$75 or more.



Verify the deduction is allowable by asking taxpayers to produce these records.

## Are there alternative methods for figuring some expenses?

There are alternative ways of reporting some expenses:

- Vehicle expenses can be reported by using the actual expense method or the standard mileage rate
- Meals and incidental expenses can be reported by using the actual amounts or a standard amount can be used to report these expenses

## What are vehicle expenses?

Vehicle expenses are expenses incurred when taxpayers use their vehicles for business purposes. If a taxpayer has qualified vehicle expenses, you figure those in Part II of Form 2106.

One of the two following methods can be used to figure a taxpayer's deductible expenses.

- The actual expense method figures the deduction based on a variety of factors, including gasoline, oil, repairs, insurance, rentals, and may even involve depreciation or the value of a vehicle provided by the taxpayer's employer.
- The standard mileage method is very simple: it multiplies the miles driven for business by a standard cost. Taxpayers may use the standard mileage rate only if they meet one of these requirements:
  - Owned the vehicle and used the standard method the first year the vehicle was put into service
  - Leased the vehicle and is using the standard method for the life of the lease



This lesson discusses only the standard mileage rate. If the taxpayer wishes to use the actual method, refer them to a professional tax preparer.

## 2008 Mileage Rates

Purpose	Cents per Mile Rates 1/1/08- 6/30/08	Cents per Mile Rates 7/1/08- 12/31/08
Business	50.5	58.5

If the taxpayer reports vehicle expenses, regardless of the method used, you must complete the General Information section in Part II of Form 2106. As with other business expenses, the taxpayer must provide records to prove the time, place, and business purpose of the travel.

### How are meals and incidental expenses figured?

Meals and entertainment expenses are figured separately from other business travel expenses. They are multiplied by a percentage: 50% for most taxpayers and 80% for those subject to Department of Transportation hours of service.

Taxpayers may report the actual amounts for meals, entertainment and incidental expenses. Alternatively, they may use a standard amount to claim meals and entertainment or incidental expenses. That is, either:

- \$3 per day for incidental expenses (tips, taxis, mailing, etc.), or
- Federal M&IE rate for meals (for rates inside the U.S., see [www.gsa.gov](http://www.gsa.gov); for rates outside the U.S., see [www.state.gov](http://www.state.gov))

In either case, the taxpayer must provide records to prove the time, place, and business purpose of the travel.



See the instructions for Form 2106 to determine if a taxpayer is subject to DOT hours of service.



See Publication 463 for details on how to figure deductions using the standard meal allowance, including special rules for partial days or travel and for transportation workers.



### EXERCISES

Answers are after the lesson summary.

**Question 1:** Which of the following is true for meals and entertainment expenses?

- A. Taxpayers may deduct meal expenses for family members if the travel can be proven to be primarily business related.
- B. Taxpayers can deduct 100% of meal and entertainment expenses that are not subject to DOT hours of service.
- C. Taxpayers may report the actual amounts for meals and entertainment and for incidental expenses or use the standard method for one or the other.
- D. All of the above.

**Question 2:** True or False: Taxpayers who can use the standard method for calculating business mileage need not produce records proving the time, place, and business purpose of the travel.

## How do I report business expenses?

Business expenses are reported on Form 2106, Employee Business Expenses, or Form 2106-EZ, Unreimbursed Employee Business Expenses. The result from Form 2106 or 2106-EZ is reported as a miscellaneous itemized deduction on Schedule A of Form 1040.

### Do I need to file Form 2106?

To determine if a taxpayer must file Form 2106, ask the taxpayer the questions shown in Who Must File Form 2106 in the Instructions for Form 2106. When taxpayers must file Form 2106, ask questions to find out if they qualify to file Form 2106-EZ. They can if they meet these requirements:

- Use the standard mileage rate, if claiming vehicle expenses
- Were not reimbursed by an employer for any expense

Form 2106 is divided into two parts. Part I calculates total travel expenses, and Part II calculates vehicle expenses. If the taxpayer incurred qualified vehicle expenses, you should complete Part II before entering an amount in line 1 of Part I:

- Section A requests general information about vehicle use. The “placed in service” date is the date the taxpayer began using the vehicle for business.
- Section B (line 22) is for taxpayers who choose to use the standard mileage rate for the vehicle.



**TaxWise Hint:** Once you enter the total mileage on line 13 of Form 2106, TaxWise will apply the standard mileage rate and carry the amount to lines 1 and 22 of the form. You can link to a scratch pad from line 13 if you need to add up mileage amounts.

- Sections C and D are for taxpayers who are using the actual expense method to calculate their vehicle expenses. This is beyond the scope of the volunteer program; refer the taxpayer to a professional tax preparer.

In Part I, you report employee business expenses and reimbursements in two columns and three steps. Column A lists all business travel expenses except meals and entertainment, and Column B lists only meals and entertainment.

- Step 1: Complete for all taxpayers who must use Form 2106
- Step 2: Complete only if the employer reimbursed the taxpayer and the reimbursement is not included as income on Form W-2, Box 1
- Step 3: Figure expenses to deduct on Schedule A:
  - Subtract the amount of reimbursement from the expenses
  - Calculate meal expenses in Column B
  - Determine the total deduction to be entered on Schedule A

#### TIP

The final deduction amount on Form 2106 may be reduced when you apply the 2% AGI limit on Schedule A.

#### TIP

Special rules apply to figuring the final amount for business travel expense deductions for ministers, armed forces reservists, certain state and local officials, qualified performing artists, and disabled employees. See Form 2106 Instructions to determine if a taxpayer will qualify under any of these categories.



## EXERCISES (continued)

**Question 3:** You should complete Step 2 of Form 2106 when the taxpayer receives \_\_\_\_.

- A. All reimbursements for expenses from the employer
- B. Expense reimbursements that were not reported as income on Form W-2
- C. Employee business expenses that exceeded reimbursements
- D. Employee business expenses that were less than expense reimbursements

## Summary

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When you help taxpayers calculate business-related travel expenses, you must identify deductible expenses. These are affected by the taxpayer's "tax home" and other factors. Also, a taxpayer cannot deduct expenses for a family member who accompanies them for pleasure on a business trip.

Not all taxpayers must file Form 2106; some may file Form 2106-EZ or require neither form. Be sure the taxpayer has proper records for expenses, and correctly reports any reimbursement amounts.



## EXERCISE ANSWERS

**Answer 1:** C. Taxpayers may report the actual amounts for meals/entertainment and for incidental expenses or use the standard method for one or the other.

**Answer 2:** False. All business expenses must be supported by records.

**Answer 3:** B. Step 2 is used only if the employer reimbursed the taxpayer and the reimbursement is not included as income on the taxpayer's tax return.





### Introduction

This lesson covers the credit for child and dependent care expenses. Some taxpayers may not be aware of this credit. Your time and effort may result in a lower tax for the taxpayer.

To determine if a taxpayer is eligible for the credit, use the interview techniques and tools discussed in the interview lesson. If filing Form 1040, calculate the amount of the credit using TaxWise Form 2441; if filing Form 1040A on paper, you will use Schedule 2 instead.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer is eligible for the credit
- Calculate the amount of the credit



Don't confuse this credit with the child tax credit!

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 2441 and instructions

#### **Optional:**

- ☐ Publication 503
- ☐ Form 1040 Instructions

### What is the child and dependent care credit?

The credit allows taxpayers to reduce their tax for a portion of their child and dependent care expenses. The credit may be claimed by taxpayers who, in order to work or look for work, pay someone to take care of their:

- Dependent children under 13
- Spouses or dependents who are unable to care for themselves

The credit can be 20%, up to as much as 35% of the taxpayer's expenses. The percentage is based on the taxpayer's earned income and adjusted gross income. The amount of the credit cannot be more than the amount of income tax on the return. It can reduce an individual's tax to \$0, but it will not give the taxpayer a refund. This type of credit is called a "nonrefundable" credit.

Some taxpayers receive dependent care benefits from their employers, which may also be called "flexible spending accounts" or "reimbursement accounts." Taxpayers may be able to exclude these benefits from their income. Employer-provided dependent care benefits appear in box 10 of the taxpayer's Form W-2.

Because the child and dependent care credit is a nonrefundable credit, only taxpayers with taxable income can claim the credit. However, all taxpayers who receive employer-provided dependent care benefits are required to complete Part III of Form 2441 or Schedule 2 to determine if they can exclude all or part of these benefits from their taxable income.

## How do I determine if a taxpayer is eligible?

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The information gathered from an approved intake and interview sheet, along with the decision tree in the Volunteer Resource Guide (Tab G) will help you determine the taxpayer's eligibility. Be sure to ask whether the taxpayer has paid for *any* type of dependent care, for example, for a spouse or other dependent.

The Volunteer Resource Guide decision tree covers the five eligibility tests the taxpayer must meet to qualify for the credit:

- Qualifying person test
- Earned income test
- Work-related expense test
- Joint return test
- Provider identification test

Use the decision tree questions in the Volunteer Resource Guide (Tab G) as a guide for your interview with the taxpayer. Keep in mind that the taxpayer must pass all five of the tests to qualify for the credit.

## What is the qualifying person test?

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The taxpayer's child and dependent care expenses must be for the care of one or more qualifying people. Refer to the Volunteer Resource Guide (Tab G) to determine who is a qualifying person. Any of the following are qualifying persons:

- A qualifying child who is the taxpayer's dependent and under age 13 when the care was provided. Only the custodial parent can take the Child and Dependent Care Credit. If the child is not being claimed as a dependent by the taxpayer because the noncustodial parent is taking the exemption under the special rules for children of divorced and separated parents, only the custodial parent may treat the child as a qualifying person for this credit.
- Dependents who were physically or mentally unable to care for themselves and for whom the taxpayer can claim a dependency exemption (or could claim except the person had \$3,500 or more of gross income or filed a joint return). This person must have lived with the taxpayer more than half the year.
- Spouses who were physically or mentally unable to care for themselves.



See the rules for Qualifying Child and the special rules for children of divorced and separated parents in Publication 17, Personal Exemptions and Dependents.

### example

Jim paid someone to care for his wife, Janet. Janet is physically unable to care for herself. Jim also paid to have someone prepare meals for their 12-year-old daughter, Jill. Both Janet and Jill are qualifying persons for the credit.

## What questions should I ask?

Ask the questions from the decision tree in the Volunteer Resource Guide (Tab G) and the approved intake and interview sheet. The sample interview shown below uses these questions.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	DOROTHY RESPONDS...
<i>Did you pay someone to watch your child, or another person that couldn't care for themselves while you were at work?</i>	Yes, I did.
<i>You may qualify for the child and dependent care credit. Let me ask you a few questions about that. Which of your dependents received the care?</i>	My daughter.
<i>Now, she is 16 years old, correct?</i>	Yes, but she has what the doctors call profound mental retardation. She just can't take care of herself.

Even though Dorothy's daughter is over 13, she meets the qualifying person test because she cannot care for herself.

Once you've determined if the taxpayer had eligible expenses for the Child and Dependent Care Credit, check the appropriate box on the approved intake and interview sheet.

## What is the earned income test?

The taxpayer (and spouse, if married) must have earned income during the year. Earned income includes:

- Wages
- Salaries
- Tips
- Other taxable employee compensation
- Net earnings from self-employment
- Strike benefits
- Disability pay reported as wages

Refer to the Earned Income Table in the Volunteer Resource Guide (Tab H) for the list of earned income.

### ***What if spouses are full-time students or are unable to care for themselves?***

A taxpayer's spouse is treated as having earned income for any month the spouse is physically or mentally unable to care for themselves, or is a full-time student. The spouse's income is considered to be \$250 for each month if there is one qualifying person in the home, or \$500 each month if there are two or more qualifying people. A full-time student is defined as enrolled and attending a school for the number of hours or classes the school considers full time. The spouse must be a student for some part of five calendar months during the year.

If, in the same month, both the taxpayer and the taxpayer's spouse are full-time students or are not able to care for themselves, only one spouse can be considered to have earned income of either \$250 for one qualifying person or \$500 for two qualifying persons for that month.



**TaxWise Hint:** The worksheet at the bottom of Form 2441, page 1, will compute the amount of income considered earned by a spouse that is a full-time student or unable to care for themselves.

### What questions should I ask?

Ask the questions from the decision tree in the Volunteer Resource Guide (Tab G) and the approved intake and interview sheet. Here is how a volunteer might interview a taxpayer about this test.

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*I believe you mentioned earlier that you and your husband both work, is that correct?*

*Did you both work while your daughter was in daycare?*

*So, he was a full-time student for the first six months of the tax year?*

*No.*

##### DOROTHY RESPONDS...

Yes.

Yes and no. My husband just changed careers. He went to school the first half of the year, but he began working full-time within a month of finishing his program in July.

Yes. Does that disqualify us?

Dorothy and her husband meet the earned income test because her husband was a full-time student for at least five months, and is considered to have earned income for those months.

### What is the work-related expense test?

Expenses are considered work-related only if both of the following are true:

- The expenses allow the taxpayer (and spouse, if married) to work or look for work, and
- The expenses are for a qualifying person's care, and to provide for that person's well-being and protection

For married taxpayers, generally both must work or be looking for work. Taxpayers' spouses are treated as working during any month the spouses were full-time students or were physically or mentally unable to take care of themselves.

There is a limit on the amount of work-related expenses that can be used to figure the credit. The limit is \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons.

## What are examples of work-related expenses?

The following expenses count as work-related:

- Cost of care outside the home for dependents under 13, for example, preschool or home daycare
- Cost of care for any other qualifying person, for example, dependent care
- Household expenses that are at least partly for the well-being and protection of a qualifying person, for example, the services of a housekeeper or cook

### example

Krista takes her 3-year-old child to a nursery school that provides lunch and educational activities as part of its preschool childcare service. She can count the total cost when she figures the credit.

## What expenses do not qualify as work-related?

Expenses that do not qualify as work-related include amounts paid for food, clothing, education, or entertainment. However, small amounts paid for these items can be included if they are incident to and cannot be separated from the cost of care.

Examples of childcare expenses that do **not** qualify as work-related include:

- Education, for example, expenses to attend kindergarten or a higher grade
- The cost of sending a child to an overnight camp
- The cost of transporting a qualifying person from the taxpayer's home to the care location and back

### example

Roger takes his 10-year-old child to a private school. In addition to paying for the cost of the education, Roger also pays an extra fee so that his child can attend a before-school and after-school program, so that Roger can go to work. Roger can count the cost of the before and after school program when figuring the credit, but not the cost of the education.

## What about taxes paid for household employees?

Taxpayers who paid someone to come into their homes to provide care for their dependent or spouse may be required to pay household employment taxes. These taxes may be considered a work-related expense. Refer to Employment Taxes for Household Employers in Publication 17 for more information.

Generally, if the household employee earned less than \$1,600 for the tax year, and the taxpayer did not withhold any income tax, the taxpayer is not required to pay employment taxes or provide the employee with Form W-2. Refer taxpayers who did not pay employment taxes for their household employees, and are unsure about these requirements, to Publication 926, Household Employer's Tax Guide, or to a professional tax preparer.

### ***What if the taxpayer makes payments to a relative?***

Payments to relatives may qualify as work-related expenses if the taxpayer does not claim the relative as a dependent. Do not count amounts paid to:

- A dependent whom the taxpayer (or spouse, if married) can claim as an exemption, or
- The taxpayer's child who is under age 19 at the end of the year, even if he or she is not the taxpayer's dependent

### **What questions should I ask?**

Continue asking questions from the decision tree in the Volunteer Resource Guide (Tab G) and the approved intake and interview sheet. Here is how a volunteer might interview a taxpayer about the work-related test.

#### **SAMPLE INTERVIEW**

##### **VOLUNTEER SAYS...**

*Did the caregivers assist your daughter only when you and your husband were at work?*

*Do you pay your mother to care for your daughter?*

*That's wonderful. You're all very fortunate. So all your expenses were only to allow you to work – or in your husband's case to go to school or look for work prior to becoming employed?*

##### **DOROTHY RESPONDS...**

That's right. We couldn't afford any more help than that. All last year, they arrived just before we left for work and they left when my mother came at 2 p.m.

No, we don't. She just does it because she loves her granddaughter.

Yes, exactly.

Dorothy passes the work-related expense test because the expenses are paid so that she and her husband can work, and are not paid to a dependent relative.

### **What is the joint return test?**

Generally, *married couples* who wish to take the child and dependent care credit must file a joint return. However, taxpayers can be considered unmarried if they file a separate return and:

- are legally separated on the last day of the tax year, or
- lived apart from their spouse for the last 6 months of the year and paid more than half of the cost of providing a home which was also the main home of the qualifying person for more than half the year

A taxpayer whose spouse died during the tax year, and who has not remarried, must generally file a joint return to claim the credit.

At this point, you will have already determined the taxpayer's filing status and can rely on that to determine if they pass the joint return test.

## What is the provider identification test?

The provider identification test requires that taxpayers provide the name, address and Taxpayer Identification Number of the person or organization who provided the care for their child or dependent.

If the care provider is an individual, the Taxpayer Identification Number is the same as the provider's social security number. If the provider is an organization, then it is the Employer Identification Number (EIN). Certain tax-exempt organizations are not required to have an EIN. See Publication 17 for more details.

Taxpayers who cannot provide all of the provider's information or who have incorrect information may still be able to take the credit if they can show that they used due diligence in trying to obtain the correct information. Refer to the sections entitled *Due Diligence* and *Provider Refusal* in Publication 17 for more information. Returns that do not include the provider information cannot be filed electronically.



### EXERCISES

Use the decision tree in the Volunteer Resource Guide (Tab G) to answer the following questions. The answers appear at the end of the lesson.

**Question 1:** Audrey is a stay-at-home mom. Her husband works and had earned income for the tax year. They have a young son with autism who must be supervised at all times. Audrey volunteers at a local autism information hotline 12 hours a week. She and her husband pay a caregiver to stay with their son during those hours.

Do they qualify for the child and dependent care credit? ☐ Yes ☐ No

**Question 2:** Why don't Audrey and her husband qualify for the credit? (Select all answers that apply.)

- The caregiver expense is not work-related
- Their son is not a qualifying person
- The caregiver's duties do not qualify as work-related
- They do not pass the earned income test

## Taxpayer Example

Bill, 61, and Helen, 62, are married and have lived together for twenty years. Earlier in the interview with Bill, you learned that Helen is too sick to work and needs 24 hour care. You wonder whether he can take the child and dependent care credit. Bill is claiming his granddaughter as a dependent, as noted in the Family/Dependent Information section of his approved intake and interview sheet. She is 18 and takes care of herself.

Apply the questions from the Credit for Child and Dependent Care Expenses decision tree in the Volunteer Resource Guide (Tab G) to find out whether Bill can take the credit, as shown in the sample interview to follow.



## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*For the credit for child and dependent care, I'd like to ask you some questions about the care provided for your wife, Helen. You may qualify for the credit.*

*Why don't you tell me about your wife's illness and care?*

*I'm sorry that she is so ill. That must be difficult for both of you.* [The volunteer has already determined earlier in the tax return preparation process that Bill has earned income from his full-time teaching job. So he skips these questions in the decision tree and moves ahead to the next relevant question.]

*Did you pay someone to take care of your wife so that you could go to work?*

*Oh, I see. Well unfortunately, I was wrong. You won't be able to take the credit for your wife because you are claiming Lucy as a dependent.*

*You're welcome. Just trying to help!*

[On the approved intake and interview sheet, indicate that the taxpayer doesn't qualify for this credit, and why.]

### BILL RESPONDS...

Oh, okay.

Well, she has chronic lung disease; she can't take care of herself at all. We need to have someone in the home 24 hours a day.

Yes, it is... well, sometimes she has good days, and I'm thankful for that.

Yes, I pay my granddaughter Lucy, who just graduated from high school, to take care of Helen.

Oh, that's okay. Thanks for looking into it for me.

A spouse would be allocated \$250.00 per month in earned income to help make the computation for the credit.

## How do I determine the amount of the credit?

Form 2441 determines the amount of the credit, by multiplying the work-related expenses (after applying the earned income and dollar limits) by a percentage. The percentage depends on the taxpayer's adjusted gross income. TaxWise performs much of the credit computation for you. On page 2 of TaxWise Form 1040, link from line 47 to bring up Form 2441. Then, enter the taxpayer's information and TaxWise calculates the credit.

The form is divided into three parts:

- Part I is for general information about the care provider
- Part II is where the child and dependent care credit is calculated
- Part III is where information is entered if the taxpayer reports employer-provided dependent care benefits

All taxpayers complete Part I first. Taxpayers who did not receive dependent care benefits from their employers then complete Part II. Taxpayers who did receive these benefits complete Part III, then Part II.

#### example

Paula has one dependent child, Jenny, who is 6 years old. She paid \$2,900 in qualified expenses. Box 10 of Paula's Form W-2 shows she received \$1,400 during the year from her employer's dependent care assistance program. Because she received dependent care benefits, Part III of Form 2441 must be completed before completing Part II.

#### ***What about employer-provided dependent care benefits?***

Some taxpayers receive dependent care benefits from their employers. Taxpayers may be able to exclude these benefits from their income. Dependent care benefits include amounts the employer pays either directly to the taxpayer or to the care provider. Employer-provided dependent care benefits appear in box 10 of the taxpayer's Form W-2.

The taxpayer may still be able to claim a child and dependent care credit, but the amount of excluded benefits is not included in work-related expenses and also reduces the dollar limit for the credit. Taxpayers who receive dependent care benefits **must** complete Part III of Form 2441, even if they are not eligible for a child and dependent care credit.



**TaxWise Hint:** TaxWise Form 2441 provides space for two care providers. If there are more than two, link from block 1(a), Care Provider's Name to a worksheet that will allow you to enter as many providers as you need. This worksheet will only provide spaces for the providers' name and address. You will also need to link from block 1(c), ID Number, to a separate worksheet where you will enter the ID number and Amount Paid for each provider.

#### ***What limits apply to this credit?***

The taxpayer's expenses are subject to an earned income limit. The amount of work-related expenses used to figure the credit cannot be more than:

- The taxpayer's earned income for the year, or
- If Married Filing Jointly, the smaller of the taxpayer or spouse's earned income for the year

In addition to the earned income limit, there is a dollar limit on the amount of work-related expenses that can be used to figure the credit. This limit is \$3,000 for one qualifying person or \$6,000 for two or more qualifying persons. If the taxpayer received dependent care benefits, the amount of the benefits excluded from income must be subtracted from the dollar limit.

#### example

Mary has three qualifying children. She received \$4,800 in dependent care benefits through her employer. When Mary figures her credit, her work-related expenses will be limited to \$1,200 (\$6,000 - \$4,800).

TaxWise guides you through applying the limits and computing the credit. If the taxpayer received employer-paid benefits, be sure to complete Part III of Form 2441 before calculating any credit on Part II. TaxWise calculates the credit by multiplying the work-related expenses by a percentage determined by the taxpayer's adjusted gross income.

## How do I avoid common errors?

---

When Form 2441 is complete, double-check your entries for the provider's name, ID number and amounts paid. If the taxpayer had an amount in box 10 of any form W-2, be sure that you have completed Part III of Form 2441.

On the approved intake and interview sheet, make sure the Part IV box is checked to indicate that the taxpayer was eligible for the dependent care credit. Note anything unusual that the quality reviewer may need to know when reviewing this part of the tax return.

## Practice - Vanessa Franklin

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-24 and review the sample interview with Vanessa related to Lesson 23.

## Summary

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The credit for child and dependent care expenses is a nonrefundable credit that allows taxpayers to reduce their tax liability for a portion of the expenses.

The maximum expense amounts are \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons.

The maximum credit rate is 35% of the taxpayer's expenses. A taxpayer must satisfy the five eligibility tests to qualify for the credit. The tests are the:

- Qualifying person test
- Earned income test
- Work-related expense test
- Joint return test
- Provider identification test

The credit is calculated on Form 2441 (Form 1040) or Schedule 2 (Form 1040A). It is reported on line 47 of Form 1040 or line 29 of Form 1040A.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



**Answer 2:** The correct answer is “the caregiver expense is not work-related” and “they do not pass the earned income test.” Audrey is not using the caregiver’s services to look for work or to perform work. In addition, both spouses must have earned income during the year to qualify. Only the husband had earned income for the tax year.

## This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

[illegible]



### Introduction

This lesson covers two tax credits available to help the taxpayer offset the costs of higher education by reducing the amount of income tax. This lesson suggests probing questions you can ask based on an approved intake and interview sheet, and the Volunteer Resource Guide (Tab G) and on the rules for claiming education credits.

During the interview, ask the taxpayer if they are aware of the education credits, and give a brief description of what they are. Next, gather information to determine if any credits can be claimed.

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- Who qualifies for an education credit
- Which credit the taxpayer can claim

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 8863
- ☐ Form 1040 Instructions

### What are education credits?

Education credits are amounts that will reduce the amount of tax due. The amount is based on qualified education expenses that the taxpayer paid during the tax year.

There are two different education credits: the Hope Credit and the Lifetime Learning Credit. There are general rules that apply to both credits, as well as specific rules for each credit.

### Who can take an education credit?

A taxpayer can take education credits for the taxpayer, spouse, and/or dependents (claimed on the tax return) who were enrolled at or attended an eligible post-secondary educational institution during the tax year.

## What basic requirements must the taxpayer meet?

In order to claim an education credit, verify that the following are true for the taxpayer:

- They cannot be claimed as a dependent on someone else's tax return
- They are not filing as Married Filing Separately
- Their adjusted gross income (AGI) is below the limitations for their filing status
- They were not nonresident aliens for any part of the tax year, or if they were, they elected to be treated as resident aliens
- There must be a tax liability (not already offset by other credits) on the return

If any of these are *not* true, the taxpayer cannot claim an education credit. Refer to the bold text in the Volunteer Resource Guide (Tab G), Education Credits, for the basic requirements.

## How do I handle dependents?

The taxpayer must claim the dependent on the return in order to claim the credit for the student's qualified expenses. Refer to the Education Credits Interview Tips in the Volunteer Resource Guide (Tab G), footnote 1, demonstrated by the following example:

### example

Erma Bradley has a grandson named Kevin. He is claimed as a dependent on his parent's joint return. Erma paid Kevin's tuition directly to the university. For purposes of claiming an education credit, Kevin is treated as receiving the money as a gift and paying for the qualified tuition and related expenses. Since his parents are claiming him on their return, they may be able to use the expenses to claim an education credit. Alternatively, if he is claiming himself on his return, he might be able to claim the expenses as if he paid them to the school.

## What is an eligible institution?

An eligible institution is any college, university, vocational school or other post-secondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. The school should be able to tell the student if it is an eligible education institution.



## What are qualifying expenses?

Qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution. Ask the taxpayer for details on each person's education expenses. Ask to see documentation, such as receipts or the Form 1098-T, Tuition Statement, issued by the school. Try to identify the expenses that qualify for education credits. For example, ask if the expense was for "tuition and related expenses" keeping these rules in mind:

- Tuition and fees must be expenses that are required for enrollment or attendance at an eligible educational institution.
- "Related expenses" must be required to be paid to the institution as a condition of enrollment or attendance. These can include required course-related fees, books, course-related supplies and equipment, but only those that must be purchased from the education institution as a condition of enrollment.



If books can be purchased at any bookstore, from a fellow student, or taken from the library, then the amount is not required to be paid to the institution and would not be a qualified expense.

## What expenses do not qualify?

Do **not** include expenses such as:

- Room and board, insurance, medical expenses (including student health fees), transportation costs, or other similar personal, living, or family expenses
- Course-related books, supplies, equipment, and nonacademic activities which are **not** required to be paid to the institution as a condition of enrollment or attendance
- Any course of instruction or other education involving sports, games, or hobbies, unless the course is part of the student's degree program or (for the Lifetime Learning Credit) helps the student to acquire or improve job skills

### example

When Janice enrolled for her freshman year of college, she had to pay a separate student activity fee in addition to her tuition. This activity fee is required of all students, and is used solely to fund on-campus organizations and activities run by students, such as the student newspaper and the student government. No portion of the fee covers personal expenses. Although labeled as a student activity fee, the fee is required for Janice's college enrollment and attendance; therefore, it is a qualified expense.

### example

Toby amassed many receipts for books and supplies his first year at college. He spent \$1,291 for required books, lab supplies, and rock-hunting equipment he needed for his introductory chemistry and geology courses. The school has no policy requiring that these books and equipment be purchased from the college in order to enroll. Another \$596 went for his student health center fees, three books and four outside therapy sessions to help him adjust to college life. None of these expenses qualify because they were not required to be paid to the institution in order to be enrolled.

example

Jill attends Wanda's School of Beauty, an eligible institution. She pays \$4,400 for the course of study, which includes tuition, equipment, and books required for the course. The school requires that students pay for the books and equipment when registering for the course. The entire \$4,400 would be an eligible educational expense.

### Are any amounts excluded from qualified expenses?

Certain tax-free funds used to pay tuition cannot be used to figure the credit. Once you have identified each person claiming a credit, and their qualified expenses, ask if the student received any of these untaxed educational benefits during the year:

- Pell grants
- Employer-provided educational assistance
- Veterans' educational assistance
- Tax-free portions of scholarships and fellowships
- Any other nontaxable payments received as educational assistance (other than gifts or inheritances)
- Refunds of the year's qualified expenses paid on behalf of a student (for example, the student dropped a class and received a refund of tuition)

Subtract the tax-free educational assistance, refunds, and benefits from the student's qualified expenses. These tax-free benefits are listed in the Education Credits Interview Tips in the Volunteer Resource Guide (Tab G).

Most students will receive Form 1098-T from the educational institution. The form should show the amounts the student paid for tuition and related expenses, the amounts of scholarships and grants received, and whether the student was at least a half-time student or a graduate student. Verify with the taxpayer that the amount in box 1 or 2 of Form 1098-T is actually the amount paid in the current tax year for qualified expenses.

☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number  <b>City College</b> <b>4011 College Dr.</b> <b>Anchorage, AK 99508</b>		1 Payments received for qualified tuition and related expenses <b>\$ 9,500</b>	OMB No. 1545-1574  <b>2008</b>  Form <b>1098-T</b>	<b>Tuition Statement</b>           <b>Copy B</b> <b>For Student</b>  This is important tax information and is being furnished to the Internal Revenue Service.
FILER'S federal identification no. <b>92-XXXXXXX</b>	STUDENT'S social security number <b>XXX-XX-XXXX</b>	2 Amounts billed for qualified tuition and related expenses <b>\$</b>	3 If this box is checked, your educational institution has changed its reporting method for 2008 <input type="checkbox"/>	
STUDENT'S name <b>Joan Smith</b>		4 Adjustments made for a prior year <b>\$</b>	5 Scholarships or grants <b>\$ 1,500</b>	
Street address (including apt. no.) <b>32 Pine St.</b>		6 Adjustments to scholarships or grants for a prior year <b>\$</b>	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2009 <input type="checkbox"/>	
City, state, and ZIP code <b>Anchorage, AK 99508</b>		8 Checked if at least half-time student <input checked="" type="checkbox"/>	9 Checked if a graduate student <input type="checkbox"/>	
Service Provider/Acct. No. (see instr.)		10 Ins. contract reimb./refund <b>\$</b>		

Form **1098-T**

(keep for your records)

Department of the Treasury - Internal Revenue Service

#### example

Joan Smith received Form 1098-T, shown above, from the college she attends. It shows her tuition was \$9,500 and that she received a \$1,500 scholarship. She had no other scholarships or nontaxable payments. Her maximum qualifying expenses for the Hope or Lifetime Learning Credit would be \$8,000 (\$9,500 - \$1,500).

### What about payments for the next academic year?

The taxpayers can claim payments prepaid for the academic period that begins in the first three months of the calendar year. Refer to the Volunteer Resource Guide (Tab G), Education Credits.

#### example

Thomas pays \$1,500 in December 2008 for qualified tuition for the winter semester that begins in January 2009. He can use the \$1,500 paid in December 2008 to compute his credit for 2008. He cannot count it again in 2009.

### What rules apply to each credit?

#### How do the credits compare?

There are several differences between the two credits. The taxpayer can claim the Hope credit based on the same student's expenses for no more than two years. However, there is no limit on the number of years for which the taxpayer can claim a Lifetime Learning Credit based on the same student's expenses.

#### Hope Credit

Taxpayers can take the Hope Credit for a student if they can answer all of these questions as indicated below:

- As of the beginning of the tax year, was the student still a college freshman or sophomore? *Yes*
- Was the student enrolled in 2008 in a program that leads to a degree, certificate, or other credential? *Yes*
- Was the student taking at least one-half the normal full-time workload for the course of study, for at least one academic period beginning in 2008? *Yes*
- Was the Hope Credit claimed for the student's expenses in more than one previous tax year? *No*
- Has the student been convicted of a felony for possessing or distributing a controlled substance? *No*

#### TIP

If the student doesn't meet all of the conditions for the Hope Credit, the taxpayer may be able to take the Lifetime Learning Credit for part or all of the student's qualified expenses.

The Hope Credit can be up to \$1,800 per eligible student, depending on the amount of eligible expenses and the amount of tax on the return. The credit is 100% of the first \$1,200 and 50% of the second \$1,200 of eligible expenses per student, up to the amount of tax. The Hope credit is available two years per eligible student.

## Lifetime Learning Credit

The Lifetime Learning Credit can be taken if the taxpayer and the expenses meet the requirements described under “What basic requirements must the taxpayer meet?” Refer to the Volunteer Resource Guide (Tab G), Education Credits Interview Tips for the basic requirements. The student need not be enrolled half-time or in a degree program, and a felony drug conviction does not disqualify the student.

The Lifetime Learning Credit can be up to *\$2,000 per tax return*, depending on the amount of eligible expenses and the amount of tax on the return. The credit is 20% of the first \$10,000 of eligible expenses paid for all students, up to the amount of tax on the return.



If there is only one eligible student on the tax return and that student has more than \$9,000 in qualified expenses, the Lifetime Learning Credit may result in a higher credit for the taxpayer, even if the student would be eligible for the Hope Credit.



### EXERCISES

Use the Education Credits Interview Tips in the Volunteer Resource Guide (Tab G) and the Comparison Table in Publication 17 to answer the following questions. Answers are at the end of the lesson summary.

**Question 1:** Bob is a full-time student in his sophomore year of college. Which credit is appropriate for him? ☐ Hope ☐ Lifetime

**Question 2:** Janice works full time and takes one course a month at night school. Some of the courses are not for credit, but they are meant to advance her career. Which credit is appropriate for her? ☐ Hope ☐ Lifetime

**Question 3:** Clark is an older student who has gone back to college half time after serving 18 months in prison for felony drug possession. Which credit is appropriate for him? ☐ Hope ☐ Lifetime

## Can a taxpayer take multiple credits?

Taxpayers cannot take multiple credits on the same student's expenses. For example:

- Do not figure the education credits based on expenses that have already been taken on Schedule A or C-EZ
- Do not take both a Hope Credit and a Lifetime Learning Credit for the same student in the same year
- Do not take a Hope Credit for the same student for more than two tax years

### example

Rhonda took a Hope Credit for her dependent son, Troy, on her 2006 and 2007 tax returns. She cannot take a Hope Credit for Troy in 2008.



**TaxWise Hint:** When completing the worksheet for an education credit, TaxWise helps you create an accurate claim. The program detects if the taxpayer is entered as a student but can be claimed as a dependent by someone else (Form 1040, line 6c is blank). However, TaxWise will not catch other errors, such as taking more than one benefit for the same taxpayer.

## How do I determine the amount of the credit?

---

Here are the general steps in figuring the amount of education credits:

1. Review the list of qualifying students and expenses, and decide if the Hope Credit or Lifetime Learning Credit is more suitable. (See the requirement discussed earlier.)
2. In the Hope or Lifetime Learning sections of Form 8863, enter each qualifying student and social security number. Be sure the student is the taxpayer, spouse, or dependent (and is declared as such on the return).
3. Enter each student's qualified expenses. Be sure that these:
  - Include only qualified expenses
  - Are reduced by untaxed benefits
  - Do not exceed the limit for the credit (\$2,400 per student for Hope, \$10,000 per return for Lifetime Learning)
4. Find the totals for each section and apply the limits, then transfer the amounts to Part III. Apply the income test and do the calculations. (TaxWise does this step for you.)



**TaxWise Hint:** From line 49 of Form 1040, link to Form 8863 Education Credits. Enter each student's name, SSN, and qualified expenses in the appropriate section of Form 8863. TaxWise does the calculations. You can enter the total amount of qualifying expenses for each student; TaxWise will apply the limits.



If you find a taxpayer claimed an education credit in a prior year and they were refunded part or all of the expenses they used to claim the Hope or Lifetime Learning credit, they may have to repay all or part of the credit. This is beyond the scope of the VITA/TCE program. Information can be found in Publication 970. Advise the taxpayer to consult a professional tax preparer.

## Taxpayer Example

Here is how our volunteer helped taxpayer, Barbara Smith, determine which education credits applied to her family.

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*Barbara, are you familiar with education credits?*

*Yes, they apply to certain expenses for post-secondary education. Did anyone in the family attend college or vocational school during the tax year?*

*There are two kinds of credits – here's a chart comparing the two education credits. [Explains the differences.]*

*I think you're right. You both meet the basic requirements, since you are both on the return and meet the income limits. Did you bring any receipts for education expenses?*

*Were her book purchases required to be paid to the school as a condition of enrollment?*

*We can only count expenses that have to be paid to the school as a condition of enrollment, so her books and her field hockey costs won't qualify. Did she receive any tax free benefits, from an employer, a scholarship, Pell grant, anything like that?*

*We don't need to count the gift. The Hope Credit is only available for a student's first two years of college, so that might be the best for you to claim. Now let's look at your expenses.*

*Are these to improve your job skills?*

*Are all of these required expenses?*

*You'll be eligible for the Lifetime Learning Credit.*

[On the approved intake and interview sheet, indicate that you've addressed education benefits.]

#### BARBARA RESPONDS...

They have something to do with tuition.

My daughter, Carla, is a freshman, going to college full time, and I am taking classes at City College.

Looks like Hope for Carla and Lifetime for me!

Yes, these are for Carla's tuition, fees, and books for the tax year. These are for extra-curricular field hockey.

Well, she needs the books for her classes, but she can buy them anywhere she wants.

Only \$5,000 from her grandfather.

All I have are tuition and fees for two classes in accounting, spring and fall semesters.

Yes, but my boss doesn't reimburse me.

Yes.

I'm so glad you were here to help me!

## Which education benefit is better for the taxpayer?

Taxpayers have several options for using education expenses to reduce taxes. They are:

- Business expenses on Schedule C-EZ, Form 1040
- Itemized deduction on Schedule A, Form 1040 (employee-related expenses only)
- Hope Credit or Lifetime Learning Credit

Compute all of the above to determine which gives the taxpayer the lowest tax. Do not claim multiple deductions for the same education expense, but use the credit most beneficial to the taxpayer.



To ensure that the taxpayer's return is accurate, you will need to compare the tax effects of the various education benefits.

## How can I avoid common errors?

---

If you complete Form 8863, make sure that you have entered the names, SSNs and education expense amount correctly. Check that you have not claimed more than one tax benefit for the same taxpayer, or taken a credit or deduction for expenses paid with a tax-free benefit like a scholarship.

On the approved intake and interview sheet, make sure that Part IV is checked to indicate that the taxpayer had education expenses. Note anything unusual that the quality reviewer may need to know when reviewing this part of the tax return. For example, you could note if some expenses were paid with a non-taxable scholarship.

## Practice – Vanessa Franklin

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Let's take a look at how a volunteer helped taxpayer Vanessa Franklin. Go to Appendix A-27 to review the sample interview with Vanessa related to the Education Credits lesson. Return to the lesson after determining which credit is better for Vanessa.

## Summary

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You are now ready to help taxpayers determine which education tax credits are best for them. When you get to this section of the return, always check the approved intake and interview sheet and ask probing questions based on the taxpayer's information and on the rules for claiming education credits.

There are two education credits that may reduce a taxpayer's tax:

- Hope Credit
- Lifetime Learning Credit

Education expenses can be used with those credits or on Schedule CEZ or Schedule A. Choose the method that will give the taxpayer the lowest tax.

One of your roles as a volunteer is to help taxpayers maximize the benefits that they are entitled to under the tax law. Stay alert to ways they can use their education expenses to lower their tax.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Intermediate - Yale
2. Advanced - Dalhart
3. Military - Sierra
4. International - Holmes



### Question 3: Lifetime

[illegible]





### Introduction

This lesson will show you how to help U.S. citizens and resident aliens file a claim for the Foreign Tax Credit. This credit applies to those who have paid or accrued foreign taxes to a foreign country on foreign-sourced income and who are subject to U.S. tax on the same income.

To help these taxpayers, you must determine which taxes and types of foreign income are eligible for the Foreign Tax Credit and accurately compute the credit using Form 1116.

If the foreign tax paid is reported on a Form 1099-INT or a Form 1099-DIV, the entire Form 1116 may not need to be completed.

If the foreign tax paid is a result of living and working outside the U.S., then all the questions on Form 1116 need to be addressed. In this situation, U.S. Armed Forces members may need to provide additional documents to the military legal assistance officer or seek assistance from a professional tax preparer.

To identify qualifying foreign income and taxes, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Use an approved intake and interview sheet to ask taxpayers questions related to credits that may be reportable. Although the Foreign Tax Credit is not specifically listed on the approved intake and interview sheet, ask taxpayers if they paid any tax to a foreign country.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine which taxes and types of foreign income are eligible for the Foreign Tax Credit
- Accurately compute the credit using Form 1116
- Calculate and report the Foreign Tax Credit as a nonrefundable credit

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 514
- ☐ Publication 4491-W
- ☐ Form 1116
- ☐ Form 1116 Instructions

### What if the Foreign Tax Credit is reported on Form 1099-INT or Form 1099-DIV?

Taxpayers who receive Form 1099-INT or Form 1099-DIV may have amounts reported in box 6, indicating that foreign taxes have been paid on their behalf by the issuer of the document. If this is true and the total of these amounts from all documents is not more than \$300 (or \$600 for filing status Married Filing Jointly), then taxpayers may choose to enter the total amount on Form 1040, line 50.

Some taxpayers may choose the simplified limitation election. Additional information can be found in the Form 1040 Instructions, Form 1116 Instructions, Publication 17, and Publication 514.

Taxpayers who must complete Form 1116 because they cannot qualify for the simplified limitation election, must be referred to a volunteer with an International certification or a professional tax preparer.

On paper returns, this amount is shown on Form 1040, line 50. The completion of Form 1116 is not required.



**TaxWise Hint:** Link to Form 1116 from Form 1040, line 50, and complete the box at the top of the form. The Volunteer Resource Guide (Tab 5) has an explanation about how the simplified limitation election can be made.

#### example

Ryan, who is single, received Form 1099-DIV that shows \$219 of foreign taxes paid (box 6) in 2008. According to Ryan, he paid no other foreign taxes. He is eligible to claim the Foreign Tax Credit and does not have to complete Form 1116.



#### EXERCISES

Answers are after the lesson summary.

**Question 1:** True or False? To claim the simplified limitation election, a taxpayer who is filing Single must have foreign taxes listed in Box 6 of 1099-DIV or 1099-INT that are equal to or less than \$300.

**Question 2:** Clyde comes to your site seeking help with his foreign tax credit. He is single and his Forms 1099-DIV show a total of \$423 of foreign tax paid. Can Clyde make the simplified limitation election? ☐ Yes ☐ No

**Question 3:** Judy and Mark are married and will file a joint return. Their Forms 1099-DIV show a foreign tax paid of \$590. Can they make the simplified limitation election? ☐ Yes ☐ No

The remaining sections of this lesson are directed at volunteers seeking an International certification. All others may proceed to Lesson 26, Child Tax Credit.



### What is the Foreign Tax Credit (FTC)?

U.S. citizens and residents compute their U.S. taxes based on their worldwide income. This sometimes results in U.S. citizens potentially having to pay tax twice on the same income: once to the government of the foreign country where the income was earned, and again to the U.S. government.

The Foreign Tax Credit (FTC) was created to help taxpayers avoid this double taxation. Taxpayers who paid income, war profits, or excess profits taxes to any foreign country or U.S. possession may be able to take a credit against their U.S. taxes for taxes paid to other countries. Like other nonrefundable credits, the FTC allows taxpayers to take a dollar-for-dollar reduction in the amount of U.S. tax owed. However, there are cases in which not all taxes paid to a foreign government on foreign-sourced income can be used in the computation of the Foreign Tax Credit.

In most cases, it is to the taxpayer's advantage to take the Foreign Tax Credit. In general, if the credit is chosen, you must take the credit for all qualified foreign taxes. However, if the taxpayer paid foreign taxes that do not qualify for the credit, they may be able to take the itemized deduction on the non-qualifying items as "Other Taxes" on Schedule A. In this situation, refer the taxpayer to a professional tax preparer. For more information, see Publication 514, Foreign Tax Credit for Individuals.

**TIP**

For additional information, see the instructions for Form 1116 and refer to Publication 514.

For a paper return, enter the foreign tax paid directly on line 50 of Form 1040, keeping in mind the limitations to elect the simplified limitation method (\$300/\$600).

## What qualifies taxpayers for the credit?

To qualify for the credit, the following requirements must be met. A taxpayer must:

- Have income from a foreign country
- Have paid taxes on that income to the same foreign country
- Not have claimed the Foreign Earned Income Exclusion on the same income (see the Foreign Earned Income Exclusion section of Lesson 15, Income – Other Income)

**TIP**

The Foreign Earned Income Exclusion is different from the Foreign Tax Credit and taxpayers can choose the approach that results in the lowest tax paid overall.

- The exclusion rules allow a portion of the foreign earned income to be excluded from taxable income so it is not taxed
- The credit rules add the foreign income to the taxable income and then reduces the U.S. tax due by some portion of taxes paid to the foreign government(s)
- You should try both methods to see which results in the lowest tax

In addition, the foreign tax must:

- Be paid to a foreign country on income derived from that country
- Be similar to the U.S. income tax
- Provide no economic benefit to the taxpayer paying the tax

**TIP**

A credit for foreign taxes can be claimed only for foreign tax imposed by a foreign country or U.S. possession.

Foreign taxes that qualify for the Foreign Tax Credit generally include taxes on:

- Wages
- Dividends
- Interest
- Royalties
- Annuities

Foreign taxes for which an individual may not take a credit include taxes:

- On excluded income
- On foreign oil-related income
- On foreign mineral income
- For which the taxpayer can take only an itemized deduction



See Publication 514, Foreign Tax Credit for Individuals, for more detailed information.

#### example

Robb Kendall and his wife are U.S. citizens who reside in France. Their Form 1040, Schedule B, Interest and Ordinary Dividends, lists \$500 interest from a U.S. bank and \$600 interest from a French bank. They paid income taxes on both amounts to both countries. On their U.S. tax return, they can compute a Foreign Tax Credit to offset the taxes they owe to the U.S. on the interest received from the French bank. They would need to check with the French taxing authorities to determine if they can claim a similar tax credit on their French tax return to offset the taxes paid to the U.S. on the interest income earned in the U.S.

#### example

Eva is a U.S. citizen who lives in Hong Kong. Eva owns her home in Hong Kong and paid \$2,000 in real estate taxes and \$1,000 in personal property taxes. She also paid \$300 in income taxes to the government of Hong Kong. She cannot claim a Foreign Tax Credit for either the real estate taxes or the personal property taxes because they are not income taxes. Eva can compute a Foreign Tax Credit on the \$300 in income taxes paid to Hong Kong.

Note: Eva can deduct the real estate taxes that she paid as an itemized deduction on her U.S. tax return. She can itemize the foreign personal property tax only if it is based on the value of the personal property.



## EXERCISES (continued)

**Question 4:** Sgt. Anne Goucher is a U.S. citizen living in Canada. She listed wages, interest income, and dividend income on her U.S. tax return. She paid taxes on each of these types of income to Canada. Sgt. Goucher can compute a Foreign Tax Credit on which of the following types of income?

- A. Wages from her job in the U.S.
- B. Interest income from a U.S. bank
- C. Interest income from a Canadian bank
- D. Dividend income from a U.S. corporation

**Question 5:** Jean, a U.S. citizen, received an inheritance upon the death of an uncle in Spain, and paid an inheritance tax to the Spanish government. Can Jean compute a Foreign Tax Credit to offset the inheritance tax she paid in Spain?

☐ Yes   ☐ No

### What is “economic benefit”?

As mentioned earlier, the foreign tax paid cannot provide a specific economic benefit for the taxpayer and be included in the Foreign Tax Credit computation. This means that the tax cannot be a payment that results in an individual receiving:

- Goods
- Services
- The right to use certain properties that are not available to others who are subject to the generally-imposed income tax, or to the general population under the same terms



According to Publication 514, Foreign Tax Credit for Individuals, a taxpayer is considered to receive a specific economic benefit if he or she conducts a business transaction with a person who receives an economic benefit from a foreign country, and under the terms and conditions of the transaction, the taxpayer directly or indirectly receives some part of the benefit.

### example

Lawrence is a business owner who lives in China, which has a two-tier income tax system:

- Everyone is taxed according to their income
- Business owners pay additional tax on their profits

The second tier entitles business owners to certain reduced fees and other benefits, such as ability to rent space in a government building. Because of the specific economic benefits Lawrence receives, he cannot use the second-tier tax payments to compute a Foreign Tax Credit on his U.S. tax return. However, the first-tier income taxes are similar to U.S. income taxes and can be used to figure his Foreign Tax Credit.

## Country Restrictions

Taxes paid to certain countries do not qualify for the Foreign Tax Credit. These are countries:

- The U.S. has designated as repeatedly providing support for acts of international terrorism, or
- With which the U.S. has no diplomatic relations

Income taxes paid to governments the U.S. does not recognize are not eligible for the Foreign Tax Credit. At the time of this writing, the following countries are not recognized:

- Cuba
- Iran
- North Korea
- Syria
- Sudan

### TIP

Foreign income earned in sanctioned countries is subject to U.S. tax. A separate Form 1116 must be completed for foreign income from a sanctioned country, using the "Section 901(j) income" category. This is beyond the scope of the volunteer program; refer the taxpayer to a professional tax preparer.



## EXERCISES (continued)

**Question 6:** Adele lived and worked in Iran until August 2008, when she was transferred to Italy. She paid taxes to each country on the income earned in that country. Can Adele take a Foreign Tax Credit on her U.S. tax return for the taxes paid on income she earned in Iran? ☐ Yes ☐ No

**Question 7:** Write "Q" next to each tax that qualifies for the Foreign Tax Credit or "NQ" next to those that do not. Assume the taxpayer is a U.S. citizen or resident living in a non-sanctioned foreign country, and that the tax is being paid to a foreign government on foreign-sourced income.

- \_\_\_ Dividend taxes
- \_\_\_ Foreign oil-related income tax
- \_\_\_ Interest income tax
- \_\_\_ Real estate taxes
- \_\_\_ Income tax on wages from a foreign country
- \_\_\_ Taxes paid on income earned in Syria

## What types of income qualify for the credit?

At the top of Form 1116, Part I, taxpayers are asked to indicate the type of foreign income they received. Two of these income categories fall within the scope of the volunteer program:

- Passive category income
- General category income

### Passive Category Income

Passive category income generally includes the following types of income, assuming the income is from another country and the taxpayer has paid taxes on it:

- Dividends
- Interest
- Royalties
- Rents
- Annuities
- Gain from the sale of property that produces such income, or non-income-producing investment property

For example, a taxpayer who lives in a foreign country and pays taxes on interest income could claim the Foreign Tax Credit and check box a, "Passive category income," on Form 1116.



A separate Form 1116 must be completed for each type of income; each Form 1116 can include income earned in as many as three foreign countries.



Wages and salaries are considered to be general category income, which is discussed later in this topic. Passive category income may qualify as general category income if the foreign government taxes it at a rate higher than the highest U.S. tax rate; see "High Taxed Income" below.

### General Category Income

General category income consists of wages earned in a foreign country that an individual does not exclude, or excludes only part of, under the Foreign Earned Income Exclusion. Additionally, foreign income that does not come under any of the other categories on Form 1116 can typically be included as general category income.

#### example

Robert paid taxes to Spain and did not elect to claim the Foreign Earned Income Exclusion. He can claim a Foreign Tax Credit for the taxes paid to Spain on his earnings from Spain.

### High Taxed Income

Some passive category income can be included in general category income if it is taxed by a foreign government at a rate higher than the highest U.S. income tax rate. In 2008, the highest U.S. income tax rate was 35% income tax. Therefore, if a taxpayer pays more than 35% income tax on the foreign-sourced passive income for which he or she claimed the credit, the credit is computed under general category income.

### example

Brenda is a U.S. citizen who lives in a foreign country and pays 45% income tax on her interest income in that country. She can list this income under the “General category income” heading on Form 1116, since the rate of income tax paid on this passive income is higher than the highest U.S. income tax rate.



### EXERCISES (continued)

**Question 8:** Regina lives in Singapore and is a U.S. citizen. She has both dividend income and interest income from countries outside the United States. Her foreign bank withholds 15% of her interest income for income taxes. She also pays foreign income taxes on her dividend income, at a rate of 40%. For the purposes of Form 1116, how should the following types of income be classified?

Interest Income: \_\_\_\_ Dividend Income: \_\_\_\_

- A. Passive category income
- B. General category income

**Question 9:** Bernard is a U.S. citizen who lives in Barbados. In 2008, he paid 17% income tax on interest income from his bank account in Barbados. For the purposes of Form 1116, Bernard’s foreign interest income should be classified as:

- A. Passive category income
- B. General category income

## Taxpayer Example

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There are several factors to consider when determining if a tax paid to a foreign government is eligible for the Foreign Tax Credit. You will need to ask the taxpayer questions to determine:

- Was the income foreign-sourced?
- What type of tax was paid to the foreign government?
- Will the taxpayer receive some kind of specific economic benefit from the payment of this tax?

Here’s how a volunteer helped Bonnie determine if she qualified for the Foreign Tax Credit:



## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

### BONNIE RESPONDS...

*The income you earned in Argentina does not qualify for the Foreign Earned Income Exclusion. Let's see if you can claim a credit on the income taxes you paid to Argentina.*

Yes, I hope I can avoid paying taxes twice on that income!

*That's why the Foreign Tax Credit was created. Since you earned income and paid taxes on that income to Argentina, but did not claim the Foreign Earned Income Exclusion, you may qualify for the credit.*

That's a relief!

*There are a few more requirements. We must determine how much of the foreign tax is similar to U.S. income tax and whether or not you received an economic benefit in exchange for those taxes.*

What does that mean?

*Wages and bank interest are taxable on your U.S. income tax return. What type of tax does Argentina charge on that income?*

It's the same kind of tax, a percentage of your income, except they withhold all of it right from your pay or bank account.

*So it's similar to the U.S. tax. Did you receive any kind of benefit, such as goods or services, or the right to use properties, as a result of paying taxes on either your wages or your interest?*

None at all.

*Then we can include both in the claim for the credit.*

[On the approved intake and interview sheet, indicate that you have addressed this credit.]

## Do I have to file Form 1116?

If the following three conditions are met, the taxpayer can take the Simplified Limitation Election, which allows taxpayers to report foreign tax on Form 1040, line 50. The total qualified foreign taxes must be:

- \$300 or less (\$600 or less if Married Filing Jointly), and
- Derived from passive income (interest, dividends, royalties, etc.), and
- Reported on Forms 1099-INT/1099-DIV



**TaxWise Hint:** If the taxpayer qualifies for the Simplified Limitation Election, link to Form 1116 from Form 1040, line 50, and complete the box at the top of Form 1116. The Volunteer Resource Guide (Tab 5) has an example of how the Simplified Limitation Election can be made. If needed, link to a scratch pad from the box at the top of Form 1116.

## How do I complete Form 1116?

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If the taxpayer does not qualify for the Simplified Limitation Election, Form 1116 must be completed. The amount of the Foreign Tax Credit is the portion of U.S. income tax liability based on gross taxable foreign income. Certain expenses can be deducted on the tax return to reduce foreign gross income. Some of these situations are complicated, and beyond the scope of the VITA/TCE program, such as:

- Expenses directly related to the foreign income, such as employee business expenses
- Investment interest expense
- Foreign losses, such as those from selling foreign assets or a loss from a business or partnership

If the taxpayer has any of these types of deductions, refer them to a professional tax preparer.

Use the following guidelines if you prepare Form 1116 for the taxpayer:

- Top portion: Only report one type of income on each Form 1116. Income from up to three foreign countries may be reported on the same form as long as it is *the same type of income*.
- Part I, line 1a: Enter all foreign income that is taxable by both the foreign countries and the U.S.
- Part I, line 3a: If the taxpayer is not itemizing deductions on Schedule A, enter the standard deduction amount on line 3a. If the taxpayer itemizes, enter the total of medical expenses, real estate taxes and gifts to charity from Schedule A. TaxWise will not automatically enter this field.



**TaxWise Hint:** TaxWise will show the correct amount of itemized or standard deduction to the left of the entry field, but the amount must be manually entered on line 3a.

- Part II: Check the appropriate box, (h) or (i), to indicate whether the foreign tax was actually paid during 2008 (“paid”) or if the tax was billed in one year but paid in another (“accrued”). A taxpayer using the cash basis can choose to use either the cash or accrual method to determine the Foreign Tax Credit. However, if the accrual method is chosen, the taxpayer must continue to use the accrual method for the Foreign Tax Credit on all future returns.
- Part II, column j, enter date.
- Part II, columns k through n – amounts are entered in foreign currency; columns o through r – amounts are entered in U.S. dollars; column s – total U.S. dollar amounts only. Conversion rates are discussed in the Other Income lesson.
- Part III: Figure the credit in this section. If the taxpayer has a carryback or carryover, refer them to a professional tax preparer.
- Part IV: Only needed if the taxpayer had to use more than one Form 1116 due to more than one type of income and/or reporting funds from more than three countries.



**TaxWise Hint:** TaxWise performs the calculations in Parts III and IV.

## Summary

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Taxpayers who paid taxes to any foreign country or U.S. possession may be able to take a nonrefundable Foreign Tax Credit (FTC) for taxes paid. Generally, to claim the FTC, taxpayers are required to file Form 1116, Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual).

However, taxpayers do not have to file Form 1116 if they meet certain requirements. The VITA/TCE Program may help taxpayers who are not required to file Form 1116. (International VITA sites are excepted from this rule.)

To qualify for the Foreign Tax Credit, the taxpayer, income, and taxes must all meet specific requirements. The Foreign Tax Credit is computed and reported on Form 1116. Part I of Form 1116 is used to figure the taxable income from foreign sources in each income category; a separate copy of Form 1116 must be completed for each category of income.

The Foreign Tax Credit is different from the Foreign Earned Income Exclusion. If the taxpayer uses the Foreign Earned Income Exclusion, foreign tax paid on the excluded income cannot be used to claim the Foreign Tax Credit. Taxpayers can choose the approach that results in the lowest tax paid overall.

The Foreign Tax Credit is reported on Form 1040, line 50.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. International - Holmes (A blank Form 1116 can be found in Appendix C of Publication 4491-W)



## EXERCISE ANSWERS

**Answer 1:** True. The \$300 limitation applies to whether or not a taxpayer has to complete Form 1116. A taxpayer does not have to file Form 1116 if the total foreign taxes paid are less than or equal to \$300 (\$600 if Married Filing Jointly).

**Answer 2:** No. Clyde needs to complete Form 1116 because his foreign taxes exceed \$300. Clyde will need to seek the assistance of a professional tax preparer.

**Answer 3:** Yes. If the foreign taxes for a married couple who files a joint return are less than or equal to \$600, then the couple is not required to complete Form 1116. Judy and Mark do not have to complete Form 1116 because their foreign taxes are less than \$600.

**Answer 4:** C. On Sgt. Goucher's tax return, she can compute a Foreign Tax Credit to offset the taxes she paid to Canada on the interest received from the Canadian bank.

**Answer 5:** No. An inheritance does not qualify as income from a foreign country. Under U.S. tax law, inheritances are not taxable to the beneficiaries. Jean is not eligible to claim a Foreign Tax Credit for the inheritance taxes she pays to the Spanish government.

**Answer 6:** No. Adele cannot take a Foreign Tax Credit for the taxes paid on income she earned in Iran. However, this income is taxable in the U.S., since she is a U.S. citizen.

**Answer 7:**

Q - Dividend taxes

NQ - Foreign oil-related income tax

Q - Interest income tax

NQ - Real estate taxes

Q - Income tax on wages from a foreign country

NQ - Taxes paid on income earned in Syria

**Answer 8:** Interest Income – A; Dividend Income –B (high taxed income is considered general category income)

**Answer 9:** A. Since 17% (the tax rate Bernard paid) is not more than 35% (the highest U.S. income tax rate), Bernard's income falls under "passive category income" on Form 1116.



### Introduction

This lesson covers a credit that first took effect in 1998. This credit is unique because it can be both nonrefundable and refundable. Some taxpayers may not be aware of these credits. Your time, effort, and understanding of this credit may result in a lower tax for the taxpayer.

The child tax credit is entered in the Nonrefundable Credits section of TaxWise; the additional child tax credit is entered in the Payments section. Form 1040EZ filers cannot take the credit.

An approved intake and interview sheet and the Interview Tips in the Volunteer Resource Guide (Tab G), are critical tools needed to determine eligibility for the credit.

#### TIP

Don't confuse these credits with the child and dependent care tax credit!

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- The taxpayer's eligibility for the credit(s)
- Which taxpayer can claim the additional credits

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 972
- ☐ Publication 4491-W
- ☐ Form 8812 and Instructions
- ☐ Form 8901 and Instructions

### What is the child tax credit?

The child tax credit is a nonrefundable credit that allows taxpayers to claim a tax credit of up to \$1,000 per qualifying child, which reduces their tax liability.

### What is the additional child tax credit?

Taxpayers who are not able to claim the full amount of the child tax credit may be able to take the refundable additional child tax credit. Completing Form 8812, Additional Child Tax Credit, may result in a refund even if the taxpayer doesn't owe any tax.

### Who can claim the child tax credit?

To be eligible to claim the child tax credit, the taxpayer must have at least one qualifying child. Refer to the Volunteer Resource Guide (Tab G) for the definition of the child for purposes of claiming the child tax credit.

#### example

Ed's son, Jeff, turned 17 on December 30, 2008. He is a citizen of the United States. According to the Interview Tips for the Child Tax Credit, he is not a qualifying child for the child tax credit because he was not under the age of 17 at the end of 2008.

### Does the child have to be the taxpayer's dependent?

Generally, taxpayers must claim the dependency exemption for the child on their return in order to claim the child tax credit or the additional child tax credit. The rules for divorced, separated, or never married taxpayers are discussed below.

Taxpayers may still be able to claim the child tax credit if their qualifying child is not their dependent because of either of the following:

- The taxpayer (and spouse if Married Filing Jointly) can be claimed as a dependent on someone else's return, or
- The taxpayer's qualifying child is married and files a joint return for the tax year (other than a joint return filed only as a claim for refund and no tax liability would exist for either spouse if they had filed separate returns)

To claim a nondependent child as a qualifying child for the purposes of the child tax credit only, taxpayers must file Form 8901, Information on Qualifying Children Who Are Not Dependents. For more information, refer to the Form 8901 Instructions.



**TaxWise Hint:** To ensure that the nondependent qualifying child is included in the Child Tax Credit computation, select Form 8901 from the list of forms. Complete the information for the nondependent child. If the child meets the age, relationship and residency tests, TaxWise will check the CTC block on Form 8901, and the qualifying nondependent will be included in the Child Tax Credit calculations on the child tax credit worksheet and Form 8812, Additional Child Tax Credit. The nondependent should not be entered on the Main Information Sheet.

### Are there special rules for children of divorced, separated, or never married parents?

There are special rules for children of divorced or separated parents, as well as for children of parents who have never married. In most cases the custodial parent (the parent having custody of the child for the greater part of the year) may claim the dependency exemption for the qualifying child. Custody, for this purpose, means the child lives in the parent's main home. The noncustodial parent, however, may be entitled to claim the dependency exemption for a child and thus the child tax credit and additional child tax credit. Review the Interview Tips for Child Tax Credit in the Volunteer Resource Guide (Tab G) for additional information.

Remember, a custodial parent's release of the dependency exemption will also release the child tax credit and the additional child tax credit, if either applies, to the noncustodial parent. Noncustodial parents must attach Form 8332 or a similar statement to their return each year the exemption is claimed.

### example

Mary and Ralph got a divorce in 2002. They have one child together, Amy, who lives with Mary. All are US citizens and have SSNs. Mary and Ralph provide more than half of Amy's support. Mary's AGI is \$31,000 and Ralph's AGI is \$39,000. Amy is 12. The divorce decree does not state who can claim the child.

Ralph, the noncustodial parent, can claim the dependency exemption and child tax credit if Mary signs Form 8332. Mary can still claim the earned income credit, Head of Household, and child and dependent care credit for Amy assuming she qualifies for them.

## What is the amount of the credit?

The maximum amount taxpayers can claim for the child tax credit is \$1,000 for each qualifying child. The amount actually claimed on Form 1040 depends on the taxpayer's tax liability, modified adjusted gross income (MAGI) and filing status. The amount of the credit may be reduced if the taxpayer's:

- Tax liability less the majority of the nonrefundable credits is less than the maximum child tax credit, or
- MAGI is above the limit for the taxpayer's filing status; review the Child Tax Credit Interview Tips in the Volunteer Resource Guide (Tab G) for the limits

Review steps 6 through 8 in the Volunteer Resource Guide (Tab G), Interview Tips to determine which worksheet must be used to figure the credit. If the taxpayer answers yes to steps 6 through 8, then the worksheet in Publication 972 must be used to figure the credit.

### example

Stan files as Head of Household and has three children who qualify for purposes of the child tax credit. Stan's MAGI is \$54,000 and his tax liability is \$4,680. Stan is eligible to take the full \$1,000 per child (\$3,000) because his MAGI is less than \$75,000 and his tax liability is \$4,680.

### example

May and Bob file as Married Filing Jointly and have two children who qualify for the child tax credit. Their MAGI is \$86,000 and their tax liability is \$954. Even though their AGI is less than the threshold limit of \$110,000, they can only claim \$954, reducing their tax to zero. As they couldn't claim the maximum Child Tax Credit, May and Bob may also be eligible for the Additional Child Tax Credit.



**TaxWise Hint:** TaxWise will do these calculations for you.

## What is MAGI?

Typically, the taxpayer's MAGI (Modified Adjusted Gross Income) is the same as their AGI from line 37 of Form 1040, or line 21 of Form 1040A. For more information on MAGI as it applies to the child tax credit, refer to Publication 17.



If the taxpayer's tax liability is zero, they cannot take the credit because there is no tax to reduce. However, the taxpayer may be able to take the additional child tax credit, discussed later in this lesson.



## EXERCISES

Use the Child Tax Credit Interview Tips from the Volunteer Resource Guide (Tab G) to complete the exercises. Answers are at the end of the lesson summary.

**Question 1:** Paul and Marie are married with two dependent children. They will file a joint Form 1040 for the year. The children are qualifying children for purposes of the child tax credit. Paul and Marie's MAGI is \$112,000 and their tax liability is \$6,200. Based on this information, Paul and Marie:

- A. Are not eligible for the maximum credit and will have to use Publication 972 to figure their child tax credit
- B. Will not have to use Publication 972 to figure their child tax credit
- C. Are eligible to claim a full child tax credit
- D. Are not eligible to claim any amount for the child tax credit

**Question 2:** Laura's adopted son Jack is 12. He is a citizen of the United States, and lived with Laura for the entire tax year, during which time Laura provided full financial support. Is Jack a qualifying child for the child tax credit? ☐ Yes ☐ No

**Question 3:** Which one of the following individuals (all of whom have two qualifying children for the purposes of the child tax credit) are eligible to claim the maximum \$1,000 per child for the child tax credit on their tax return?

- A. Fiona, who is Married Filing Separately with a MAGI of \$60,000
- B. Ken, a Qualifying Widower with a MAGI of \$30,000 and tax liability of \$490
- C. Nick, who is Single with a MAGI of \$70,000 and a tax liability of \$5,000
- D. Julie, who is Married Filing Jointly with a MAGI of \$116,000



## How do I determine taxpayer eligibility for the credit?

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To determine whether a child meets the criteria of qualifying child for the child tax credit or additional child tax credit, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Begin by reviewing the Family and Dependent Information section of the taxpayer's approved intake and interview sheet. Verify that the child:

- Is under 17 on December 31 of the tax year
- Lived with the taxpayer for at least 6 months of the year (remember the special rules for divorced, separated, or never married parents)
- Meets the relationship criteria
- Is a U.S. citizen, U.S. National, or resident of the United States

If the Family and Dependent Information section is incomplete, or the taxpayer is unsure of how to respond, you may want to use the Interview Tips for Child Tax Credit in the Volunteer Resource Guide (Tab G). It provides helpful probing questions to ask the taxpayer.



**TaxWise Hint:** Based on the information you enter in the Dependents/Nondependents section, TaxWise automatically checks the CTC box to show qualifying status. Refer to the Main Information Sheet in the Volunteer Resource Guide (Tab 1).



**TaxWise Hint:** If the qualifying child is a resident of the U.S. but does not have a valid SSN or ITIN, you must override the CTC box on the Main Information Sheet.

## How do I calculate the child tax credit?

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To calculate the credit, you must first determine which worksheet to use. Review the Child Tax Credit Interview Tips in the Volunteer Resource Guide (Tab G) to determine which worksheet the taxpayer must use.

### How is the credit calculated in TaxWise?

If you are using TaxWise, the system will automatically calculate the credit, provided you have correctly completed the:

- Dependent/Nondependent section of the Main Information Sheet, and
- Taxpayer's return through the retirement savings contribution credit line

If you have a question about the amount that appears as the child tax credit, you can link to display a completed Child Tax Credit Worksheet for your taxpayer. This may help you understand the results of the system's calculation.

## What is the additional child tax credit?

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### What is the amount of the credit?

This credit is for certain individuals who get less than the full amount of the child tax credit. The additional child tax credit may give a taxpayer a refund even if you do not owe any tax.

Like the child tax credit, the additional child tax credit allows eligible taxpayers to claim up to \$1,000 for each qualifying child after subtracting the allowable amount of child tax credit. The credit is generally based on the lesser of:

- 15% of the taxpayer's taxable earned income that is over \$12,050, or
- The amount of unused child tax credit (caused when tax liability is less than allowed credit)

### Who can take the credit?

Review the Additional Child Tax Credit Tip in the Volunteer Resource Guide (Tab G) to see the requirements to claim the credit.

#### example

Remember May and Bob who have two qualifying children, a MAGI of \$86,000, and a tax liability of \$954? Because their tax liability is less than the full amount of the credit (in their case \$2,000) they may be able to take the additional child tax credit of \$1,046 (\$2,000 - \$954).

### Are there any exceptions?

There are exceptions for taxpayers with three or more qualifying children. Taxpayers with earned income less than \$12,050, who have three or more qualifying children, may still qualify for the credit if they:

- Had social security or Medicare taxes withheld from their pay
- Were self-employed and paid self-employment tax
- Paid tax on tips not reported to their employer

The amount of the taxpayer's earned income credit is a factor in this calculation on Form 8812.

### How do I calculate the additional child tax credit?

Form 8812, Additional Child Tax Credit, is used to calculate the additional child tax credit. If you are using TaxWise, the system will verify the taxpayer's eligibility and calculate the credit amount. The credit will appear on the additional child tax credit line of the Payment section of Form 1040 in TaxWise. If you want to view the calculations on Form 8812, link to bring up the completed Form 8812.



## EXERCISES (continued)

**Question 4:** Jose and Yolanda Alameda are Married Filing Jointly and have five dependent children under the age of 17. Jose and Yolanda both have valid SSNs. Their children have Individual Taxpayer Identification Numbers (ITINs). The children are qualifying children for purposes of the child tax credit, but not the earned income credit. Jose and Yolanda's AGI is \$8,850 and their tax liability is \$0. Their social security and Medicare taxes are \$677. Their earned income credit amount is \$438. Are they eligible to take the additional child tax credit? ☐ Yes ☐ No

### How do I avoid common errors?

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When considering the Child Tax Credit, it is critical to ensure that the taxpayer has been interviewed thoroughly to correctly identify eligible children. Once the CTC block on the Main Information Sheet is checked or Form 8901 is completed, TaxWise will compute the amount of the credit automatically. If preparing a paper return, be sure to use the worksheets to figure the credit, and determine if the Additional Child Tax Credit should be included.

Be sure to note any unusual situations on the approved intake and interview sheet. For example, if a person listed in the Family and Dependent Information section cannot be claimed as anyone's dependent (perhaps the taxpayer is also someone's dependent), make a note if the nondependent child is still eligible for the Child Tax Credit.

### Practice - Vanessa Franklin

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Take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-28 and review the sample interviews with Vanessa related to lesson 26.

### Summary

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The child tax credit is a nonrefundable credit that allows qualifying taxpayers to reduce their tax liability to the lesser of the amount of the credit or their adjusted tax liability. In most cases, the eligible child must be claimed as a dependent. But there are some situations in which the taxpayer may have a qualifying child for this credit who cannot be claimed as a dependent. In those cases, Form 8901 is required to identify the nondependent qualifying child.

If a taxpayer is not able to benefit from the maximum \$1,000 per qualifying child, the taxpayer may be eligible for the additional child tax credit, which is a refundable tax credit.



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



## EXERCISE ANSWERS

**Answer 1:** A. Paul and Marie's MAGI is over the threshold of \$110,000. Therefore, they are not eligible to claim a full child tax credit and must use Publication 972 to calculate a reduced credit.

**Answer 2:** Yes. Jack is a qualifying child for the child tax credit because he was under the age of 17 at the end of 2008; he meets the relationship requirement, lived with Laura for at least 6 months of the year; and Laura provided his complete support.

**Answer 3:** C. Nick may be able to take the full \$1,000 credit for each of his qualifying children because his MAGI is not affected by the threshold limit of \$75,000 for his single filing status. In addition, his tax liability of \$5,000 is more than the amount of \$1,000 per child for the credit.

**Answer 4:** Yes. Jose and Yolanda qualified for the initial child tax credit. However, they couldn't benefit from it because their tax liability (0) was less than their allowable child tax credit (\$5,000). Even though their AGI is less than \$12,050, they have more than three children and paid social security and Medicare taxes. This makes them eligible to qualify for the additional child tax credit. Keep in mind the Earned Income Credit amount will affect the final calculation.



### Introduction

This lesson provides the information you need to be able to prepare a return with certain nonrefundable credits. The Basic Course includes Credit for the Elderly or the Disabled, and the Retirement Savings Contribution Credit. The other miscellaneous credits covered in this lesson are part of the Intermediate, Advanced, Military, or International Courses.

These credits are reported in the Tax and Credits section of Form 1040, U.S. Individual Income Tax Return.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Calculate the credit for the elderly or disabled by completing Schedule R, Form 1040, or Schedule 3, Form 1040A, Credit for the Elderly or Disabled.
- Calculate the credit for qualified retirement savings contributions by completing Form 8880, Credit for the Qualified Retirement Savings Contributions.
- Calculate the residential energy credit by completing Form 5695, Residential Energy Efficient Property Credit.
- Identify the alternative motor vehicle credit and mortgage interest credit as requiring a professional tax preparer.

Remember to use the interview techniques and tools discussed in the Screening and Interviewing lesson. Use the information on an approved intake and interview sheet, along with the documents provided by the taxpayer to determine eligibility for these credits.

### What is a nonrefundable credit?

A credit is a dollar for dollar reduction of the tax liability. A refundable credit is added to the federal income tax withheld and any estimated tax payments. If the total is more than the total tax, the excess will be refunded to the taxpayer. A nonrefundable credit can only reduce the tax liability to zero. All the credits discussed in this lesson are nonrefundable credits.

Generally, nonrefundable credits are applied against federal tax in the order they are listed on Form 1040, page 2, in the Tax and Credits section.

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W, Workbook
- ☐ Form 1040
- ☐ Schedule R, Form 1040
- ☐ Form 5695
- ☐ Form 8880
- ☐ **Optional:** Form 1040 Instructions



**TaxWise Hint:** TaxWise will calculate these credits, but the correct information must be input. The volunteer tax preparer must make the correct determinations by using an approved intake and interview sheet and resource materials.

## How do I handle the Credit for the Elderly or the Disabled?

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The credit for the elderly or the disabled is calculated on Form 1040, Schedule R, Credit for the Elderly or Disabled, and reported in the Tax and Credits section of Form 1040. This credit can also be claimed on Form 1040A, Schedule 3, Credit for the Elderly or Disabled. However, if you are using TaxWise, it will automatically start with Form 1040.

### Who qualifies for the credit for the elderly or the disabled?

Individuals who qualify for the elderly or the disabled credit are:

- Age 65 or older, **or**
- Under age 65, retired on permanent and total disability, receiving taxable disability income, and have not reached the mandatory retirement age their company has set

Besides being a qualified individual, their total income must be within certain limits. The income limits can be found in the Credits section of the Volunteer Resource Guide (Tab G).

*Mandatory retirement age* is the age set by a taxpayer's employer at which the taxpayer would have been required to retire, had the taxpayer not become disabled.

Generally, disability income comes from an employer's disability insurance, health plan, or pension plan. The payments replace wages for the time the taxpayer missed work because of the disability. The plan must provide for disability retirement for the payments to be considered disability income.

Few taxpayers qualify for this credit because the credit calculation includes the taxpayer's nontaxable social security, veterans' benefits, or other excludable pension, annuity, or disability benefits. Most taxpayers' social security benefits alone exceed the limit.

#### example

John is unmarried and filing a single return. He is 67 years old and received \$12,000 in nontaxable social security benefits in the tax year. His AGI is \$9,000. Even though John is a qualified individual, he is not eligible to claim the credit since his nontaxable social security benefits exceed \$5,000.

### How do I determine the amount of the credit?

Schedule R, Credit for the Elderly or the Disabled, is used to calculate the credit, and has three parts:

- Part I, Filing Status and Age
- Part II, Statement of Permanent and Total Disability, ensures that taxpayers who are under 65 have obtained a completed Physician's Statement that proves they are permanently and totally disabled
- Part III, Figure Your Credit

If the taxpayer is 65 or over, or under 65 and retired on permanent and total disability, complete Schedule R to determine the amount of the credit, if any.



**TaxWise Hint:** TaxWise uses the data from the Main Information Sheet and income amounts entered on the return to:

- Determine whether a taxpayer may be eligible for the credit
- Complete most of Schedule R if the taxpayer is eligible

If Schedule R pops up on your taxpayer's TaxWise form tree:

- From line 48 on TaxWise Form 1040, link to open Part III of Schedule R
- On line 13a, TaxWise automatically enters the nontaxable social security benefits and nontaxable portion of railroad retirement benefits received (as long as you have entered these items in the Income section of Form 1040, line 20a, and linked to the social security and RR tier one benefits worksheet)
- On line 13b, you may need to enter the taxpayer's nontaxable pensions, annuities, or disability benefits that were excluded from income

If the taxpayer appears to meet the income requirements, TaxWise automatically:

- Completes the rest of the form
- Transfers the amount of the credit on line 24 to line 48 of Form 1040



Since TaxWise automatically calculates the credit for the elderly or disabled, it is critical that all social security and railroad retirement benefits treated as social security be entered on the TaxWise worksheet for line 20a of Form 1040. Amounts must be entered even if no social security is taxable.



## EXERCISES

Review the information in the Credit for the Elderly or the Disabled chapter in Publication 17 to answer this question. The answer is at the end of the lesson summary.

**Question 1:** Which one of the following items would automatically disqualify someone who is under 65 years old from claiming the credit for the elderly or the disabled?

- A. Participating in sheltered employment
- B. Receiving taxable disability benefits during the year
- C. Failing to attach a Physician's Statement to the tax return
- D. Earning at least minimum wage by performing productive work

## Taxpayer Example

### Determining Albert's Eligibility

Albert comes into the tax center. He has almost completed his Form 1040A but wants to know if he can claim the credit for the elderly or disabled. Follow along in the conversation.

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*Are you either a U.S. citizen or a resident alien?*

*Are you over 65?*

*Are you retired on permanent and total disability?*

*Sounds like you may qualify. What is your adjusted gross income?*

*How much did you receive in social security?*

*Did you receive any other pension benefits that might not be taxable?*

*And your filing status is Single, so it looks like you might be able to claim the credit. If you would like for me to do your return, I will go back through it step-by-step to make sure.*

##### ALBERT RESPONDS...

Yes, I'm a U.S. citizen.

No, I'm only 54, not even old enough for retirement. But I had to stop working last year because of my disability.

Yes. In fact, I started receiving disability retirement benefits last August.

\$15,430.

I got \$4,430 in social security benefits.

No, I just get my disability checks and social security.

Refer to the Credit for the Elderly or the Disabled table in the Volunteer Resource Guide (Tab G). The table shows that Albert's AGI (\$15,430) is under the limit for a single filer under 65 (\$17,500), and his income from nontaxable social security or pension benefits (\$4,430) is also within the limit for a single filer under 65 (\$5,000).

### Which form is used to calculate the Retirement Savings Contributions Credit?

The retirement savings contributions credit is calculated on Form 8880, Retirement Savings Contributions Credit, and reported in the Tax and Credits section of Form 1040.

### What is the retirement savings contributions credit?

The retirement savings contributions credit is a nonrefundable credit a qualifying taxpayer may claim if they made a contribution to a qualified plan.

If the contribution is tax deferred, the taxpayer obtains the benefit of the tax deferral and a credit against their taxes. A "double" benefit such as this is rarely allowed. For example, a taxpayer may be able to claim this credit *and* a deduction for an IRA contribution.



## Who is eligible for the retirement savings contributions credit?

Take a look at the Volunteer Resource Guide under the Credits tab. Review the flowchart for qualifications for the Retirement Savings Contribution Credit.

## What are qualified plans for the purpose of the retirement savings contributions credit?

Another qualification is that the taxpayer must have contributed to a qualified plan. Plans that qualify are listed in the Other Credits chapter of Publication 17.

### *How do I know if the taxpayer has made a qualifying contribution?*

When you complete page 2 of the approved intake and interview sheet, be sure to ask if the taxpayer made a contribution to an IRA or other retirement account. The other qualifying plan contributions will be listed on the taxpayer's Form W-2 in box 12 and preceded by one of the following codes: D, E, F, G, H, AA, BB or S. For Military personnel, there may be an amount in box 14 coded with "Q" and/or "E" and, if the amount is qualifying, the box that says "qualifies for Form 8880" should be checked. Look at the Form W-2 Instructions in the Volunteer Resource Guide under the TaxWise Income tab.



**TaxWise Hint:** If you entered Form W-2 into TaxWise correctly and completely, TaxWise will do the credit calculation.



**TaxWise Hint:** If the taxpayer contributed to a Roth or a traditional IRA, whether it is deductible or not, you should:

- Link from Line 32 of Form 1040 to open the IRA worksheet
- Enter IRA contributions on the appropriate line of the worksheet
- Close the worksheet



Starting in 2006, some employers allowed employees to contribute after-tax money to a Roth 401(k). These after-tax contributions are listed on Form W-2 in Box 12 with a code AA or BB.

### *What may reduce an eligible contribution for purposes of the credit?*

Eligible contributions are reduced by the following distributions received during the testing period:

- Any distribution that is included in the taxpayer's gross income from a qualified retirement plan or from an eligible deferred compensation plan
- Any distribution from a Roth IRA that is not a qualified rollover contribution

The testing period includes:

- The tax year, and
- The two preceding tax years, and
- The period between the end of the tax year and the due date of the return (including extensions)



You must question the taxpayer to determine if there have been any distributions in the testing period.

### *Married Filing Jointly*

For married taxpayers filing a joint return, both spouses may be eligible for a credit on a maximum annual contribution amount of \$2,000 each. If either spouse has a distribution during the testing period, *both* spouses must reduce their eligible contribution by that amount.

#### example

Jose and Lucy are married and will file a joint return. Their combined adjusted gross income was \$39,000. They each contributed \$3,000 to a 401(k) plan. They did not receive any distributions during the three-year period and cannot claim any other credits. Jose and Lucy are each eligible for a credit based on the maximum eligible annual contribution amount of \$2,000 each.

#### example

Joe and Mary are married and filed joint returns in 2006 and 2007, and plan to do so in 2008. Joe received a taxable distribution from a qualified plan in 2006 and a taxable distribution from an eligible deferred compensation plan in 2007. Mary received distributions from a Roth IRA in 2007.

Both Joe and Mary made eligible contributions to an IRA in 2008 and otherwise qualify for the retirement savings credit. They must reduce the amount of their qualifying contributions in 2008 by the total of the distributions they received in 2006 and 2007. This calculation is completed on Form 8880.

### How do I determine the amount of the credit?

Form 8880, Credit for Qualified Retirement Savings Contributions, is used to figure the amount of the credit.



**TaxWise Hint:** Form 8880 will appear in the forms tree highlighted in red and will need to be filled out prior to return completion.

The credit can be as low as 10% or as high as 50% of a maximum annual contribution of \$2,000 per person depending on filing status and adjusted gross income.



### EXERCISES (continued)

**Question 2:** Which of the following taxpayers, who contributed to their employers' 401(k) plans, is possibly eligible for the retirement savings credit?

- A. Ed, who is Single and has an adjusted gross income of \$35,200
- B. Sybil, who is Married Filing Jointly and has an adjusted gross income of \$49,500
- C. Bert, who is Married Filing Separately and has an adjusted gross income of \$28,300
- D. Carl, who is a Qualifying Widower and has a modified AGI of \$27,000

### Taxpayer Example

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Our volunteer is working with taxpayer Ryan Wells.

Ryan, 28, who is not a full time student, is filing as Single and has contributed \$1,500 to a 401(k) during the tax year. He has not received any distributions during the tax year or the two prior years. His adjusted gross income is \$25,000.

**Form 8880**

Department of the Treasury  
Internal Revenue Service

Name(s) shown on return  
**Ryan Wells**

**Credit for Qualified Retirement Savings Contributions**

► Attach to Form 1040, Form 1040A, or Form 1040NR.  
► See instructions on back.

OMB No. 1545-0072

**2008**

Attachment  
Sequence No. **55**

**CAUTION** You **cannot** take this credit if **either** of the following applies.

- The amount on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36 is more than \$26,500 (\$39,750 if head of household; \$53,000 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral (a) was born after January 1, 1991, (b) is claimed as a dependent on someone else's 2008 tax return, or (c) was a **student** (see instructions).

Your social security number  
**000 00 0000**

	(a) You		(b) Your spouse	
1 Traditional and Roth IRA contributions for 2008. Do not include rollover contributions	1	0		
2 Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18)(D) plan contributions for 2008 (see instructions)	2	1,500		
3 Add lines 1 and 2	3	1,500		
4 Certain distributions received after 2005 and before the due date (including extensions) of your 2008 tax return (see instructions). If married filing jointly, include both spouses' amounts in both columns. See instructions for an exception	4	0		
5 Subtract line 4 from line 3. If zero or less, enter -0-	5	1,500		
6 In each column, enter the smaller of line 5 or \$2,000	6	1,500		
7 Add the amounts on line 6. If zero, stop; you cannot take this credit			7	1,500
8 Enter the amount from Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36	8	25,000		
9 Enter the applicable decimal amount shown below:			9	

If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
Enter on line 9—				
---	\$16,000	.5	.5	.5
\$16,000	\$17,250	.5	.5	.2
\$17,250	\$24,000	.5	.5	.1
\$24,000	\$25,875	.5	.2	.1
\$25,875	\$26,500	.5	.1	.1
\$26,500	\$32,000	.5	.1	.0
\$32,000	\$34,500	.2	.1	.0
\$34,500	\$39,750	.1	.1	.0
\$39,750	\$53,000	.1	.0	.0
\$53,000	---	.0	.0	.0

**Note:** If line 9 is zero, stop; you cannot take this credit.

10 Multiply line 7 by line 9	10	150
11 Enter the amount from Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 43	11	1,176
12 <b>1040 filers:</b> Enter the total of your credits from lines 47 through 50, line 12 of the Line 11 Worksheet in Pub. 972 (see instructions), plus the amounts, if any, from line 13 of Form 8396, line 20 of Form 5695, and line 7 of Form 8859.  <b>1040A filers:</b> Enter the total of your credits from lines 29 through 32.  <b>1040NR filers:</b> Enter the total of your credits from lines 44 and 45, line 12 of the Line 11 Worksheet in Pub. 972 (see instructions), plus the amounts, if any, from line 13 of Form 8396, line 20 of Form 5695, and line 7 of Form 8859.	12	0
13 Subtract line 12 from line 11. If zero, stop; you cannot take this credit	13	1,176
14 <b>Credit for qualified retirement savings contributions.</b> Enter the smaller of line 10 or line 13 here and on Form 1040, line 52; Form 1040A, line 33; or Form 1040NR, line 47	14	150

\*See Pub. 590 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 33394D

Form **8880** (2008)

TaxWise picks up the \$1,500 401(k) amount from box 12 of Ryan's Form W-2 (previously input), enters it on line 2 of Form 8880, and displays a red exclamation point next to Form 8880 on the forms tree.

After asking Ryan about distributions, the volunteer fills in the required information.

TaxWise prompts you to answer a question regarding the taxpayer's status as a student on Form 8880. It then calculates Ryan's retirement savings contributions credit of \$150, then transfers this amount to Form 1040.

**Basic students can proceed to the Practice – Vanessa Franklin section at the end of this lesson.**



## What is the Residential Energy Efficient Property Credit?

Individuals who make purchases for certain energy efficient property for their main home may be allowed a nonrefundable tax credit. For 2008, this credit has changed. The costs for items such as insulation and storm doors no longer qualify for a credit.

Form 5695, Residential Energy Efficient Property Credit, is used to compute the credit.

A credit is available to those who add qualified solar panels, solar water heating equipment, or a fuel cell power plant to their homes in the United States. The limitation on this section cannot exceed 30% of qualified purchases. If not used in 2008, this credit can be carried forward to 2009.

The taxpayer must own their home to qualify for these credits. In your initial interview you should have discovered if your taxpayer owned a home or not. When you get to line 53, be sure and ask the taxpayer if they qualify for this energy credit.



Be sure to ask taxpayers if they claimed the energy credit in tax year 2007. You may need the information from the taxpayer's 2007 Form 5695 to properly compute the credit for 2008.



**TaxWise Hint:** TaxWise will do all the math calculations for you and enter the total on the appropriate line of Form 1040.

Remember, at any time you need some help and want to see the form instructions, click anywhere on the form and access the help feature.

Form <b>5695</b>		<b>Residential Energy Efficient Property Credit</b>		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service		<p>▶ See instructions.</p> <p>▶ Attach to Form 1040 or Form 1040NR.</p>		<p><b>2008</b></p> <p>Attachment Sequence No. <b>158</b></p>	
Name(s) shown on return				Your social security number	
<b>Before you begin:</b> Figure the amount of any District of Columbia first-time homebuyer credit you are claiming.					
<b>Note.</b> Skip lines 1 through 12 if you only have a <b>credit carryforward from 2007</b> .					
1	Qualified solar electric property costs	1			
2	Multiply line 1 by 30% (.30)	2			
3	Maximum credit amount	3	\$2,000		
4	Enter the smaller of line 2 or line 3	4			

## What about the Alternative Motor Vehicle Credit?

Form 8910, Alternative Motor Vehicle Credit, is used to claim a credit for alternative motor vehicles that meet certain requirements. This topic is out of scope for the volunteer program and is included for awareness only. Taxpayers who claim this credit must complete Form 6251, Alternative Minimum Tax, which is also out of scope for the volunteer program. Refer taxpayers who wish to claim this credit to a professional tax preparer.

## What is the Mortgage Interest Credit?

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Taxpayers who hold qualified mortgage credit certificates (MCCs) under a qualified state or local government program may claim a nonrefundable credit for mortgage interest paid. The taxpayer must have a document titled, "Mortgage Credit Certificate, (MCC)." The amount of the credit is listed on the certificate.

This topic is introduced in the VITA/TCE training for informational purposes only. Taxpayers who wish to claim this credit should seek the assistance of a professional tax preparer.

## How are the total nonrefundable credits reported?

---

The total of all nonrefundable credits is reported on line 55 of Form 1040.



**TaxWise Hint:** Based on your entries for all the credits, TaxWise calculates the total of the taxpayer's credits and enters the amount on line 55. Remember, the nonrefundable credits cannot exceed the taxpayer's federal income tax.

## Practice – Vanessa Franklin

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Go to Appendix A-30, to determine if Vanessa is able to take the Credit for Qualified Retirement Savings Contributions.

## Summary

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### Credit for the Elderly or the Disabled

Elderly individuals (65 or older) and individuals under age 65 who retired on permanent and total disability may be able to claim a special nonrefundable credit on their tax returns if they are U.S. citizens or resident aliens. Few taxpayers qualify for this credit because most taxpayers' social security benefits exceed the income limits.

Publication 17 provides a flowchart for determining basic eligibility. The Volunteer Resource Guide provides a quick reference table of income and social security limits. Schedule R, Credit for the Elderly or the Disabled, is used to calculate the credit.

### Retirement Savings Contributions Credit

Taxpayers who contributed to certain retirement plans or IRAs may be eligible for a nonrefundable qualified retirement savings contributions credit.



The amount of the credit is determined by the taxpayer's filing status, adjusted gross income, and the taxpayer's qualified retirement contributions.

Form 8880, Credit for Qualified Retirement Savings Contributions, is used to calculate the credit.

### Residential Energy Credits

The residential energy efficient property credit is available to taxpayers for making energy-saving improvements to their home. Form 5695, Residential Energy Efficient Property Credit is used to claim the credit.

### Alternative Motor Vehicle Credit

Taxpayers may be able to claim a credit for an alternative motor vehicle placed in service for business or personal use after 2005. Refer taxpayers who may qualify for this credit to a professional tax preparer.

### Mortgage Interest Credit

The mortgage interest credit is calculated on Form 8396. Refer taxpayers who may qualify for this credit to a professional tax preparer.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



### EXERCISE ANSWERS

#### ***Credit for the Elderly or the Disabled***

**Answer 1:** *D. Someone who still engages in substantial, gainful activity and has not yet retired on permanent and total disability is ineligible for the credit. A Physician's Statement is not required to be attached to the return, but it must be completed and kept with the taxpayer's records. Individuals under 65 must have received taxable disability benefits during the year to qualify for the credit.*

#### ***Qualified Retirement Savings Contributions Credit***

**Answer 2:** *B. Sybil qualifies for the credit because her adjusted gross income is under \$53,000, which is the threshold limit for Married Filing Jointly. A taxpayer who is Single, a Qualified Widower, or is Married Filing Separately cannot have an adjusted gross income of more than \$26,500.*



### Introduction

This lesson will help you determine the additional taxes that apply to each taxpayer's situation. This is a critical step in completing an accurate tax return.

"Other Taxes" are separate from the income tax figured from the tax tables or using the Tax Computation Worksheet. They include:

- Self-employment tax
- Social security and Medicare taxes on tip income
- Additional taxes on IRAs and other qualified retirement plans
- Advance earned income credit payments
- Household employment taxes

These amounts are usually calculated on their own form or schedule. They are reported in the Other Taxes section of Form 1040, U.S. Individual Income Tax Return.



**TaxWise Hint:** TaxWise provides all the forms and schedules you need in order to figure and report these taxes. Link to these forms from the applicable line on the TaxWise screen. The program makes most of the calculations and displays the resulting tax on Form 1040.



If you are not certified to prepare a return including additional taxes on IRAs and other qualified retirement plans, then refer taxpayers with this issue to a more experienced volunteer or a professional tax preparer. Household employment taxes are beyond the scope of the volunteer program. Taxpayers who must file household employment taxes should be referred to a professional tax preparer.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the different types of other taxes on a return
- Determine if a taxpayer is liable for these other taxes that are within scope of the volunteer program
- Determine how to report these additional taxes on the tax return, along with applicable forms or schedules

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form W-2
- ☐ Form 4137
- ☐ Schedule SE

#### **Optional:**

- ☐ Form 1040 Instructions
- ☐ Form 5329 and Instructions
- ☐ Publication 334
- ☐ Publication 531



## What is self-employment tax?

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Self-employment (SE) tax is social security and Medicare tax collected primarily from individuals who work for themselves. It is similar to the social security and Medicare taxes withheld from the pay of most wage earners. Payments of SE tax contribute to the taxpayer's coverage under the social security system. Social security coverage provides the taxpayer with retirement, disability, survivor, and hospital insurance (Medicare) benefits.

## Who must pay self-employment tax?

SE tax must be paid if either of the following applies:

- The taxpayer had income as a church employee of \$108.28 or more
- The taxpayer receives net earnings from self-employment income in the amount of \$400 or more (excluding church employee income)

Generally, taxpayers who are independent contractors and receive Form 1099-MISC must file Schedule C/CEZ and Schedule SE. Since the payer does not withhold taxes from independent contractors' pay, it is the taxpayer's responsibility to pay income and SE tax.

Schedule SE contains two ways to compute the tax: the long version and the short version. The instructions on the form guide you in deciding which version the taxpayer requires.

## How do I figure and report this tax?

As a volunteer, you may be qualified to assist self-employed taxpayers who need to complete Schedule C-EZ, Net Profit from Business (covered in an earlier lesson). Transfer the amount of self-employment income from Schedule C-EZ line 3 to Schedule SE line 2 and follow the instructions to calculate the self-employment tax. In addition, taxpayers can deduct half of their self-employment tax as an adjustment to income. This is similar to the benefit that employees receive because their employers pay half of the total amount paid to the Social Security Administration.



**TaxWise Hint:** TaxWise provides electronic versions of Schedule C-EZ and Schedule SE. It automatically transfers the appropriate information from Schedule C-EZ to Schedule SE, calculates the self-employment tax, and displays the amount on Form 1040, line 57. It also calculates the adjustment of one-half of the self-employment tax and displays this amount on Form 1040. Go to the Volunteer Resource Guide (Tab 2) and look for the How/Where to Enter Income page. Review the guidance for Form 1040, line 12, and footnote 2, which explains how TaxWise automatically calculates self-employment tax.





## What about taxes on unreported tip income?

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### Who must pay these taxes?

All tip income is subject to federal income tax. However, tips of less than \$20 per month not reported to the employer are not subject to social security and Medicare taxes.

Individuals who receive \$20 or more per month in tips from any one job must report their tip income to their employer. The employer reports these tips as part of the wages on Form W-2, box 1. The employer withholds social security and Medicare taxes and federal income tax on that income.

### What about allocated tips?

An employer may “allocate” tips to an employee if the employee worked in a restaurant, cocktail lounge, or similar business and reported tips that were less than the employee’s share of 8% of food and drink sales. If the employer allocates tips to employees, the amount is reported on Form W-2, box 8. This amount is to be included on Form 1040. Social security and Medicare taxes are not withheld on allocated tips. The employee pays the social security and Medicare taxes by completing Form 4137.

If the employee can show, using Publication 1244, Employee’s Daily Record of Tips and Report to Employer, or some similar daily tip record, that the actual tips received are different from the allocated amount, then the actual amount is reported on Form 1040. The actual tips received are also reported on Form 4137 to calculate social security and Medicare taxes.

### What about tips that the employee did not report to the employer?

If the employee received \$20 or more in unreported cash and charge tips in any month from any job, the employee must report that income on Form 1040 and pay the social security and Medicare taxes on that income. But, if the employee received less than \$20 in tips in any month from any job, they are not required to report them to the employer. However, these amounts *do* need to be included on Form 1040. They will not be subject to social security or Medicare taxes.

If a taxpayer is filing a paper return and only has unreported tips of less than \$20 per month, Form 4137 is not required since social security and Medicare tax is not applicable. However, in TaxWise, all tips are reported on Form 4137 because TaxWise calculates social security and Medicare taxes only on the applicable tips. TaxWise will then add unreported tips to Line 7 on Form 1040.



**TaxWise Hint:** When the allocated tips amount in box 8 is entered on the TaxWise W-2 screen, TaxWise combines that amount with the wages entered in box 1 and carries the total to Form 1040, line 7. However, when there are unreported tips that need to be included, the total should be entered on line 4 of Form 4137, Social Security and Medicare Tax on Unreported Tip Income. The total of tips that were not reported because they amounted to less than \$20 in a month are entered on line 5 of Form 4137. This will allow TaxWise to calculate the correct social security tax and add the income amount to Form 1040, line 7.

### example

Carla waits tables at a café. Her employer reports all tips that customers add to their credit card tabs, but she leaves it up to Carla to keep track of her cash tips. Carla receives more than \$20 per month in cash tips. Carla keeps a record but, because she doesn't report her cash tips to her employer, they are not included on her Form W-2. Carla includes the unreported tips as income on Form 1040, line 7. Carla also uses Form 4137 to calculate and pay the social security and Medicare taxes on those tips.

### How do I figure and report these taxes?

As part of your interview, explain to taxpayers that sometimes people do not realize they owe taxes on tips they do not report to their employer. Also explain the taxes paid on those tips actually boost the taxpayer's future social security benefits.

Then ask, "Did you receive \$20 or more in cash and charge tips in any month that you did not report to your employer?" If they answer "yes," determine if that income was included in the income reported on Form 1040, line 7; if it wasn't, be sure that amount is entered on the appropriate form.

If preparing a paper return, use Form 4137:

- Line 1 should be the total amount of tips received, whether or not the tips were reported to the employer. Allocated tips should be included in the line 1 amount unless the taxpayer has reliable records to prove they received a different amount.
- Line 3 is the amount of tips reported to the employer (which should match the amount on Form W-2, box 7).
- If the employee did not report tips to the employer because less than \$20 was received during one month, this amount should be entered on line 5, and also included in line 1. These amounts are taxable income, but are not subject to social security and Medicare taxes.
- The rest of the form computes the amount of social security and Medicare taxes due.
- Report the tax amount on Form 1040, line 58.

### How do I enter unreported tips into TaxWise?

Open the Volunteer Resource Guide (Tab 2), and go to the How to Enter Unreported Tips page. Review Form 4137 and read How to enter Unreported Tips shown below the form.



## EXERCISES

Answers follow the lesson summary.

**Question 1:** Jody had a summer job at a coffee hut. She made \$18 in tips in May, \$755 in June, \$600 in July, and \$45 in August. Until a co-worker told her, she didn't realize she had to report her tips to their employer. She then reported \$1,000 in tips to her boss.

What amount of tips will have to be added to income on line 7 of Jody's Form 1040?

- A. \$1,418
- B. \$1,000
- C. \$418
- D. \$18

**Question 2:** What amount of unreported tips does Jody have to pay social security and Medicare taxes on when she files her tax return?

- A. \$1,418
- B. \$400
- C. \$45
- D. \$18



## What about taxes on IRAs and other qualified retirement plans?

### Who must pay these taxes?

#### *Contributions to and Distributions from IRAs and Qualified Plans*

Traditional IRAs and other "qualified plans" allow individuals to defer paying taxes on money they contribute and on the earnings until the funds are distributed.

If the rules for contributions and distributions are not followed, additional penalty taxes may be due. For example, the taxpayer must pay income tax due plus an additional tax if:

- A distribution is taken before the individual reaches the age of 59 ½ and is not rolled over into another qualified plan or IRA and no other exception applies, or
- Minimum distributions are not withdrawn when required, or
- Excess contributions are not removed by the due date of the return including extensions

The additional tax for each situation is outlined on Form 5329, Additional Taxes on Qualified Plans (including IRAs) and other Tax Favored Accounts. While completion of Form 5329 is out of scope, volunteers need to be aware of the exceptions to the additional tax. Refer to chapters 10 and 17 of Publication 17 for the list of

#### TIP

Frequently, taxpayers who receive Form 1099-R with code 1 in box 7 are subject to the 10% additional tax for premature distribution because the money received has been spent for items that do not meet any of the exceptions.

exceptions. Taxpayers that may qualify for an exception must complete Form 5329 and should be referred to a professional tax preparer.

Refer to the question on the approved intake and interview sheet regarding pension or IRA distributions. If the answer is “yes,” ask the taxpayer for any Form 1099-R that reports these payments.



If Form 1099-R correctly shows code 1 in box 7, indicating that an additional tax applies, guidelines permit entering 10% of the taxable amount directly on Form 1040, line 59. “No” is entered to the left of line 59 to indicate Form 5329 is not required. TaxWise does this automatically based on entries on Form 1099-R.

#### example

John is 39 years old and received Form 1099-R with code 1 in box 7. He used the money to pay for car repairs. For the additional tax, John enters 10% of the taxable amount on Form 1040, line 59. John also enters “no” to the left of that line to indicate that Form 5329 is not required.

IRA distributions, pensions, and annuities are covered in the Retirement Income lesson. If you are not certified above the Basic Level, refer taxpayers with these issues to a more experienced volunteer or to a professional tax preparer.



## What are Advance Earned Income Credit Payments?

When a taxpayer qualifies for the Earned Income Credit (EIC), the amount of the credit is reported in the Payments section of Form 1040. That means that the EIC amount is treated as a refundable credit. It reduces the taxes due and they receive their EIC payment when they file their return. EIC will be covered in a subsequent lesson.

Taxpayers can choose to get payments of EIC in their paychecks instead of waiting to get their EIC all at once when they file their tax return. To receive advance EIC payments, the taxpayer must have, or expect to have, a Qualifying Child and submit a Form W-5, Earned Income Credit Advance Payment Certificate, to their employer. The employer will include a portion of the Earned Income Credit in the employee’s regular pay. Farm workers are excluded. The amount of advance EIC is reported on the employee’s Form W-2, box 9. If Advance EIC is received, the taxpayer is required to file a tax return, even if the taxpayer’s gross income is below the amount required to file.

#### example

Claire lives with her 2 year-old and knows that she qualifies for EIC in 2008. She arranges to receive a portion of the credit as part of her paycheck during 2008, rather than waiting to receive the full amount after filing her 2008 return.

## How does AEIC affect tax?

AEIC is EIC that was paid to the taxpayer during the tax year. The AEIC amount must be reported on Form 1040 in the Other Taxes section. On the same return, the EIC amount must be reported in the Payments section.

The AEIC is added to the total tax and EIC is subtracted from the total tax. Reporting the numbers in this way ensures that the taxpayer receives all the earned income credit to which they are entitled. If this is the case for a taxpayer you are helping, be sure to explain this and answer any questions. This could result in the taxpayer owing tax or receiving an additional amount if their income changed during the year.

#### example

When the volunteer helped Claire prepare her tax return, the AEIC amount of \$550 was reported in the Other Taxes section. The \$1,776 in EIC for which she qualified was reported in the Payments section. As a result, her tax return reflected the advance payment of her EIC and she is allowed the remaining \$1,226 as part of her 2008 refund.



**TaxWise Hint:** Be sure that Form W-2 is entered in its entirety. Information from box 9 will automatically display on Form 1040, line 60. The AEIC box is checked to reflect that this entry is for advance earned income credit.



#### EXERCISES (continued)

**Question 3:** Gloria had advance earned income credit (AEIC) paid to her during the year. The amount in box 9 of her Form W-2 was \$700.

Gloria qualified for an EIC amount of \$1,025. Her income tax was \$200 and her withholding was \$1,000. There were no other payments, credits or other taxes. What is the final amount on her tax return show? Choose the best answer below.

- A. Gloria owes tax of \$1,125
- B. Gloria has an overpayment of \$2,025
- C. Gloria has an overpayment of \$1,125
- D. Gloria has an overpayment of \$1,825

**Question 4:** Ramon has two children and expects to qualify for EIC in 2008. He needed the cash as soon as possible. He arranged to receive advance EIC payments throughout 2008, rather than waiting to file his 2008 return to get the entire EIC amount. In what section of his tax return are the AEIC payments reported?

- A. Income
- B. Other Taxes
- C. Payments
- D. Adjustments to Income

## How do I figure total tax?

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When you have completed Form 1040, lines 56 through 60 (and the corresponding forms and schedules), add up the amounts from lines 56 through 60 and enter the total on line 61. This is the total tax. This amount takes into account the tax on all income, adjustments to income, deductions, nonrefundable tax credits, and other taxes. The next step is entering the tax payments and finding the taxes owed or the amount overpaid that will result in a refund.

## Practice – Vanessa Franklin

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-33 and review to the sample interview with Vanessa related to lesson 28.

## Summary

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This lesson explained how to complete the Other Taxes section of the return. "Other taxes" are not calculated using the income tax tables or the Tax Computation Worksheet. They include:

- Self-employment tax
- Social security and Medicare taxes on unreported tip income
- Additional taxes on IRAs and other qualified retirement plans
- Advance Earned Income Credit payments

These amounts are calculated on separate forms or schedules. TaxWise provides all of the forms and performs most of the calculations.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes

Since you have not covered EIC and refund/amount of tax owed, stop the problem after the Other Taxes section of the return.



**Answer 4: B. Other Taxes**

[illegible]



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## Introduction

This lesson covers the Payments section of the tax return, which includes refundable credits and payments made by the taxpayer. These include:

- Federal income tax withheld from Form(s) W-2 and Form(s) 1099
- 2008 estimated tax payments and amounts applied from the 2007 return
- Amounts paid with a request for extension to file
- Recovery rebate credit
- First-time homebuyer credit

The Payments section also includes the Earned Income Credit and the Additional Child Tax Credit, which are covered in other lessons.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the types of payments and credits that are applicable for most low- and moderate-income taxpayers. These include:
  - Federal income tax withheld from Form W-2, Wage and Tax Statement
  - Federal income tax withheld from Forms 1099
  - Estimated tax payments and amounts applied from the prior year's return
  - Payments made with a request for extension
  - Recovery rebate credit
  - First time homebuyer credit
- Report these payments and credits correctly on the taxpayer's return

### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form W-2
- ☐ Form W-4
- ☐ Form 1040
- ☐ Form 1040 Instructions
- ☐ Form 1040-ES
- ☐ Form(s) 1099
- ☐ Form 4868

### **Optional:**

- ☐ Publication 505
- ☐ Form 5405

The information you obtain from an approved intake and interview sheet will help you determine the payments that should be reported on the taxpayer's return. In other lessons, you will learn about the earned income credit and the additional refundable portion of the child tax credit. If you are preparing a paper return, use the interview techniques and tools discussed in those lessons to determine a taxpayer's eligibility to claim these credits, and to calculate the credits on the appropriate forms.

Refer to the Other Taxes and Payments section of the Volunteer Resource Guide (Tab 6) to identify and review the Payments section of the return.

## How do I report federal income tax withheld?

You will report federal income tax withheld from various income statements received by the taxpayer. Federal income tax is a “pay as you go” system. Generally, employers are required to withhold tax from wages. The withholding from wages is reported on Form W-2, Wage and Tax Statement. Tax may also be withheld from pensions, bonuses, commissions, unemployment compensation, and other sources of income. The payer lists the withholding amounts on the applicable Form 1099 received by the taxpayer. Gambling winnings and withholding are reported on Form W-2G, Certain Gambling Winnings.

### TIP

For a household employee, an employer should withhold federal income tax only if the household employee asks the employer to withhold it and the employer agrees.

### TIP

The number of withholding allowances claimed by the employee on Form W-4, Employee Withholding Certificate, affects the amount of withholding on wages.

### TIP

Form W-4P, Withholding Certificate for Pension or Annuity Payments, is used to notify the payer of the amount of income tax to withhold. Other withholding certificates:

- Form W-4S, Request for Federal Income Tax Withholding from Sick Pay
- Form W-4V, Voluntary Withholding Request (generally used for certain government payments)

When preparing paper returns, the total amount of federal withholding is entered on page 2 of Form 1040, on the line for the federal income tax withheld from Forms W-2 and 1099.

### example

Freda worked as a clerk and received a Form W-2 that reported federal income tax withholding of \$1,000. She also received Form 1099-INT from her bank, which reflected federal income tax withholding of \$50. The correct total withholding reported on her return would be \$1,050 (\$1,000 + \$50).



**TaxWise Hint:** By the time you reach the Payments section, you have already entered information from the taxpayer’s Form(s) W-2 and Form(s) 1099 into TaxWise, including the federal income tax withheld. TaxWise calculates the total and displays it on line 62.

## What about estimated taxes and amounts applied from 2007?

### What are estimated tax payments?

Many taxpayers have income from self-employment, dividends, interest, capital gains, rent, and royalties. The “pay as you go” system also applies to this income – if the tax due on this income exceeds certain limits, estimated tax must be calculated and paid, usually each quarter, by the taxpayer. If estimated payments are not paid when they are required, a penalty could be imposed. This also applies to taxpayers whose employers withhold too little tax during the year.



The estimated tax needs to cover all the taxpayer's obligations, including the self-employment tax. Self-employment tax is the social security and Medicare taxes owed by self-employed workers.

#### example

Bob has a car repair business and all of his income for 2008 was from self-employment. Bob did not make any estimated tax payments. He filed his return and paid the full amount of the taxes owed on the return. Even though he paid the full amount with the return, he may also have to pay an estimated tax penalty.

### Who needs to pay estimated tax payments?

Taxpayers who meet both of the following conditions should have paid estimated tax for 2008:

1. After subtracting withholding and credits on their 2008 return, they still owed \$1,000 or more, **and**
2. Their withholding and credits did not cover at least:
  - 90% of the tax to be shown on their 2008 tax return, or
  - 100% of the tax shown on their 2007 tax return if that return covered all 12 months

#### example

Gloria has a booming one-person home business. She paid estimated tax each quarter of 2008 because she knew that her tax would be at least \$1,000 and that she had no withholding to cover either 90% of the current year's tax or 100% of the tax on her 2007 return.

### Where do I get this information?

On the approved intake and interview sheet, determine if there is income from sources such as self-employment or investment income for which taxes may not have been withheld. When interviewing the taxpayer ask, 'Did you pay estimated taxes to the IRS during 2008?' If the answer is 'yes,' ask to see the taxpayer's record of payments, such as Form 1040-ES, Estimated Tax for Individuals. Look for the taxpayer's response to this question on the approved intake and interview sheet.

If taxpayers should have paid estimated taxes but did not, explain the requirement so they can avoid penalties in the future. Form 1040-ES includes instructions and a worksheet for computing the amount of estimated taxes.



Suggest the taxpayer obtain Form 1040-ES for details about estimated taxes. Forms can be obtained by downloading from [www.irs.gov](http://www.irs.gov) or calling toll-free, 1-800-829-3676.



If a taxpayer paid substantially more than required in withholding tax or estimated tax, encourage them to recalculate both. They can adjust their withholding by submitting a revised Form W-4 to the payer or they can adjust their estimated tax payments by following the instructions and worksheet on Form 1040-ES.



If the taxpayer owes a large amount of taxes on the return and most of the income is from wages, the taxpayer may want to request additional amounts to be withheld. This can be done by submitting a revised Form W-4 to the employer to increase the withholding.

### What about tax payments applied from a previous year?

Taxpayers who overpay their income taxes in one year can apply all or part of their overpayment to the next year's tax by indicating the amount they want to apply to the next year's estimated taxes.

### Where do I get this information?

Ask the taxpayer:

- Did last year's return show an overpayment?
- Did you apply any part of the overpayment to this tax year?

If the answer is 'yes' to both questions, ask to see the 2007 tax return to document the amount of tax applied to 2008. Add this amount to the estimated tax payments and enter the total on the applicable line. You will be confirming information provided by the taxpayer that should be included on the approved intake and interview sheet.



**TaxWise Hint:** From the line for estimated tax payments on Form 1040, link to the F/S Tax Pd - 2008 Federal Estimate/State Payments worksheet. The worksheet includes fields for recording the date and the amount of each estimated tax payment. It also provides space for recording the amount of taxes overpaid in 2007 that were applied to the amount owed in 2008. TaxWise adds these entries and displays the total on the line for estimated tax payments and the amount applied from prior year on Form 1040.

### Taxpayer Example

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Let's see how our volunteer helped a taxpayer, Ernie, with this part of the Payments section.

## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

### ERNIE RESPONDS...

*Let's complete the Payments section of your return. TaxWise added up all the income tax withheld from your Forms W-2 we entered earlier. I know you had a little self-employment income and I see you responded "yes" to the question on estimated tax payment on the intake and interview sheet. Is that correct?*

Yes, I did.

*Do you have a record of your payments, perhaps on a Form 1040-ES?*

Yeah, here it is.

*Good, you paid each quarter. We'll enter those payments. While we're here, did last year's return show an overpayment?*

Yes, here it is: \$150.

*Did you apply any of that to your 2008 taxes?*

Yes, all of it.

*Okay, we'll enter that too. Now we show the total of the withholding from your W-2s, your estimated tax paid and the refund amount from last year's return applied to this year.*

Good!

## What about amounts paid with an extension to file?

Taxpayers can get an automatic 6-month extension of time to file by filing Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. This form extends the time to file until October 15. This is only an extension to file, not an extension to pay – if taxpayers do not pay the tax due by April 15, 2009, they will owe interest and may be charged penalties.

Later, when taxpayers file their return, they report the payment made with Form 4868 on the applicable line in the Payments section of Form 1040.

### example

One of Bernice's Forms W-2 was lost in the mail. She requested a copy from her former employer, but it did not arrive by April 15. She filed for an extension, calculated the amount of taxes owed based on her final pay stub from that employer, and paid the \$243 that was due. When she finally received her Form W-2, she filed her return and reported the \$243 on the applicable line in the Payments section of Form 1040.

## How can taxpayers file the extension?

Taxpayers may file the extension on paper or electronically. The extension must be mailed or transmitted by the due date of the return.

You can help taxpayers file for an extension using TaxWise.

Go to the Volunteer Resource Guide (Tab 6) to review the step-by-step procedures for filing for an extension using TaxWise.

## What are other payments?

### What other types of payments are there?

You will notice that the Payments section of Form 1040 also lists these credits:

- Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains
- Form 4136, Credit for Federal Tax Paid on Fuels
- Form 8801, Refundable Credit for Prior Year Minimum Tax
- Form 8885, Health Coverage Tax Credit

If you encounter someone who has such credits, refer the taxpayer to a professional tax preparer.



## What is the First-time Homebuyer Credit?

For 2008, a new law applies to homes purchased on or after April 9, 2008 and before July 1, 2009. This is a refundable credit equal to 10 percent of the purchase of a home (up to \$7,500) for first-time homebuyers. Taxpayers receiving this tax credit will be required to repay any amount received under this new law back to the government over 15 years, in equal installments. The credit begins to phase out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 in the case of a joint return). The credit is taken on Form 1040, line 69. A new form has been developed for this credit. If available, refer to Form 5405.



## How do I calculate the Recovery Rebate Credit?

This credit is based on whether the taxpayer received an Economic Stimulus Payment and if certain requirements are met.

First, you will need to know if the taxpayer received an Economic Stimulus Payment in 2008. If the answer is "yes," you will need to find out the amount. Review the approved intake and interview sheet, Part V, for the new question about the economic stimulus payment. The Form 1040 Instructions include a worksheet that will help you calculate this credit amount. Go to the Volunteer Resource Guide, pages 10-13, for guidance and interview tips on the recovery rebate credit.

### Part V. For Completion by a Certified Volunteer

**Volunteer Preparer Instructions:** You must conduct a thorough interview to complete an accurate return. This Intake/Interview Sheet is the start of your conversation with the taxpayer. Use the decision trees in Publication 4012, Volunteer Resource Guide, while discussing the questions on this form. **Remember to ask for all documentation.**

Did the taxpayer receive an Economic Stimulus Payment last year?

☐ Yes ☐ No If yes, how much? \_\_\_\_\_





**TaxWise Hint:** TaxWise will automatically compute the recovery rebate credit. This credit is based on the amount of the Economic Stimulus Payment (ESP) received by the taxpayer. For that reason, it is essential to determine if the taxpayer received an ESP in 2008, and the amount of the payment, in order to obtain the correct credit amount.

**TIP**

The Volunteer Resource Guide (pages 10-13) includes guidance and interview tips on the recovery rebate credit.

**example**

Mary received \$300 for her ESP in the summer of 2008 based on her situation. In 2008, she had a baby and will be entitled to an additional amount in the form of a credit on her 2008 return. Mary is entitled to a recovery rebate credit, which is calculated on the worksheet and entered on line 70, Form 1040.

**How do we find the total payments?**

Figuring the total tax payments is easy – add lines 62, 63, 64a, and 65 through 70. Enter the total on the total payments line of Form 1040.



**TaxWise Hint:** TaxWise totals all payments automatically and displays the result on line 71.

**Practice - Vanessa Franklin**

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Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-35 and review the sample interview with Vanessa related to Lesson 29. Review the Payment section of Vanessa's return in Appendix B-5. Return to this lesson after you have reviewed this information.

**Summary**

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The Payments section of the tax return is critical to an accurate return. It lists all the tax payments the taxpayer made during the year, as well as the refundable credits for which the taxpayer may qualify. You must be able to identify the types of payments and credits that apply to people who qualify for volunteer return preparation assistance.



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes

## Notes

This image shows a single page of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page, leaving small margins at the top and bottom. There are no vertical margin lines, and the page is completely blank except for the lines themselves.



### Introduction

This lesson covers the Earned Income Credit (EIC). There are several common errors associated with claiming this credit on the return. Publication 4012, Volunteer Resource Guide, and the approved intake and interview sheet are critical tools in avoiding these mistakes.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer is eligible for the Earned Income Credit
- Calculate the Earned Income Credit

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 596
- ☐ Publication 4491-W
- ☐ Form 1040
- ☐ Form 1040 Instructions

### What is the EIC?

The Earned Income Credit (EIC) is a refundable tax credit for most people who work but do not earn high incomes. The purpose of the EIC is to reduce their tax burden and to supplement the wages of working families whose earnings are less than the maximums for their filing status. Eligible taxpayers can receive a refund of this credit, even if they have no filing requirement, owe no tax, and had no income tax withheld.

The EIC can be a very valuable credit. For example, in 2008, the maximum Earned Income Credit for families with two or more children is \$4,824. The EIC amounts are adjusted for inflation every year.

Taxpayers with at least one qualifying child may choose to receive part of their Earned Income Credit in advance. They can do this by filling out Form W-5 with their employer. A part of the credit is given to them in their paychecks during the year. This is referred to as the Advance Earned Income Credit. This amount is listed on Form W-2, box 9. In the Volunteer Resource Guide (Tab 2), turn to TaxWise Income. Locate box 9 on the sample Form W-2 in the box marked "Advance EIC payment."

If the taxpayer received advance EIC as shown in box 9 on Form W-2, a return must be filed to report the advanced payment and claim any additional EIC.

You can learn more about Advance EIC in the Other Taxes lesson.

The EIC is entered in the Payments section of the tax return. In the Volunteer Resource Guide (Tab 6), turn to the tab titled Other Tax Payments. Find the lines on Form 1040 where the AEIC and the EIC are entered on the return.

## How does a taxpayer qualify for the EIC?

There are general sets of rules for claiming the Earned Income Credit:

- Rules for everyone
- Rules for taxpayers with a qualifying child
- Rules for taxpayers who do not have a qualifying child

### What rules apply to everyone?

The taxpayer must meet all the rules to qualify for the Earned Income Credit. Turn to the chart titled Summary of EIC Eligibility Requirements in the Volunteer Resource Guide (Tab H). Review Part A, Rules for Everyone, and Part D, Earned Income and AGI Limitations.



Both earned income and adjusted gross income must be below the limits in order for the taxpayer to qualify for the EIC. These amounts are adjusted for inflation every year.



Individual Taxpayer Identification Numbers (ITINs) and Adoption Taxpayer Identification Numbers (ATINs) cannot be used when claiming the EIC. If a couple is filing a joint return, both spouses must have SSNs to qualify for the EIC. However, if a valid number is obtained later and the taxpayer meets all the qualifications, an amended return may be filed claiming the EIC.

### What is “earned” income for EIC purposes?

Earned income is wages, salaries, tips, and other taxable employee pay. Turn to the Earned Income Table in the Volunteer Resource Guide (Tab H) for examples of earned income.

One type of payment considered earned income is “taxable long-term disability benefits received prior to minimum retirement age.” Disabled taxpayers can sometimes receive a disability pension from the company even though they are younger than the minimum retirement age. Minimum retirement age is generally the age at which taxpayers can first receive a pension or annuity from their company if they are not disabled.

Taxpayers usually receive Form 1099-R reporting the pension.

In the Volunteer Resource Guide (Tab 2), turn to TaxWise Income. Find the page showing a picture of Form 1099-R. A distribution code of “3” in box 7 indicates this is a disability pension.

Ask if the taxpayer is still under the plan’s minimum retirement age. If they are, report this income on line 7 of Form 1040 or Form 1040A. If they are at or above the company’s minimum retirement age, report this as you would a regular pension. Sometimes the company never changes the code 3 in box 7 to indicate that this is now regular pension income.



There is a limit to the amount of investment income a person can receive and still qualify for the EIC. For 2008, the amount is \$2950. Investment income includes such items as taxable interest and dividends, tax-exempt interest, capital gain net income, and income from residential rental property.



**Tax Wise Hint:** On Form 1099-R, select the “Check if disability and the taxpayer is disabled” box if the distribution is a disability pension and the taxpayer has not yet reached minimum retirement age. TaxWise will report this income on line 7 of Form 1040.



Nontaxable combat pay is shown in box 12 of Form W-2, designated with code Q.

### What about combat pay?

Combat pay is never taxable to the soldier. Members of the U.S. Armed Forces who served in a combat zone may elect to include their nontaxable combat pay in their earned income for the purposes of computing this credit only. Doing this may increase or decrease the taxpayer’s EIC. Figure the EIC amount with and without the pay before making the election. If the election is made, *all* of the nontaxable combat pay must be included. If both spouses filing a joint return have combat pay, they can individually choose to make the election on the tax return.



**Tax Wise Hint:** If you correctly enter all fields of Form W-2 into TaxWise, the software will automatically compute the EIC with and without nontaxable combat pay, and will choose the method that results in the highest EIC for the taxpayer.



VITA volunteers preparing paper returns should be sure to use the EIC worksheets (in Form 1040 Instructions) and compare which method would provide the taxpayer with the most beneficial credit.

### What about self-employment income?

Net earnings from self-employment are considered earned income. For most taxpayers within the scope of the volunteer program, “net earnings” for EIC purposes will be the amount reported on line 12 of Form 1040, minus the deduction for one-half of self-employment tax that is reported in the Adjusted Gross Income section of the tax return.

#### example

Jeff’s self-employment income reported on Form 1040 line 12 is \$2,000. The deduction for one-half of his self-employment tax, which is recorded in the adjustments section of Form 1040, is \$141.

His income for EIC purposes is  $\$2000 - \$141 = \$1859$ .

**Reminder:** Non-wage income received for doing work (such as for side jobs or contract labor) is self-employment income, even for taxpayers who do not think of themselves as “self-employed.” All self-employment income should be reported on Schedule C-EZ, Net Profit from a Business. Since the VITA program only instructs preparers on how to file Schedule C-EZ, taxpayers with a loss or other reason to file Schedule C will need to seek the assistance of a professional tax preparer.



Volunteers must remember to include all allowable expenses when completing Schedule C-EZ.

## What about household employee income?

Domestic employees such as maids are only issued Form W-2 if their earnings are more than \$1,600. The income should be added to line 7 on Form 1040 and Form 1040A and line 1 of Form 1040EZ. If there is no Form W-2, you should write HSH next to the amount on the corresponding line. This income should also be included in the computation of the EIC.

## Earned income not qualifying for the EIC

One income item that is reported on Form W-2, but does not qualify as earned income for EIC purposes, is income received for work while an inmate in a penal institution (including work performed while in a work release program or while in a halfway house). When preparing a paper return, refer to the Volunteer Resource Guide (Tab H) to find this listed in the Earned Income Table. Make a note in the Volunteer Resource Guide that this particular income is *subtracted* from other earned income on the EIC worksheet in the section titled Earned Income. Enter the initials **PRI** and the amount on the dotted line next to Form 1040 line 7.



**TaxWise Hint:** Enter income earned while an inmate in a penal institution on the TaxWise EIC Worksheet titled “figuring the credit.” TaxWise will subtract this amount from other earned income.



### EXERCISES

Use the Summary of EIC Eligibility Requirements Chart in the Volunteer Resource Guide (Tab H) to answer the following questions. Answers follow the lesson summary.

**Question 1:** A taxpayer is filing as Married Filing Separately. Can this taxpayer qualify for the EIC? ☐ Yes ☐ No

**Question 2:** A taxpayer has interest income of \$3,000. His earned income is only \$7,000. He is single, has a valid social security number and is not the qualifying child of anyone else. Does he qualify for the EIC? ☐ Yes ☐ No

## What are the rules for taxpayers with Qualifying Children?

The taxpayer must file Form 1040 or Form 1040A to claim the EIC with a Qualifying Child. The taxpayer has a qualifying child for EIC purposes if the child meets **all** the tests outlined in the Volunteer Resource Guide (Tab H). A short version of the rules is shown in Part B, Rules if you have a Qualifying Child. A detailed version is on the next page of the Volunteer Resource Guide.

### example

Robyn is 25 years old. She and her 2-year-old son, Aiden, lived with Robyn's mother all year. Aiden has a valid social security number.

Using the Interview Tips (EIC with a Qualifying Child) from the Volunteer Resource Guide (Tab H), based on what we have learned so far about Robyn and her family:

Step 1 is YES

Step 2 is YES

Step 3 is YES

Step 4 is NO

Step 5 is YES

For step 6, check to see if Aiden can be anyone else's qualifying child, for EIC purposes.

Who else lived in the house that is related to Aiden? Robyn's mother also lives with them. Go through the steps to see if Aiden can be a qualifying child for Robyn's mother.

As you'll discover, Aiden is a qualifying child for both Robyn and her mother. The taxpayers can decide who will claim Aiden for EIC and other tax benefits.

However, remember from a previous lesson, only one person can claim the same qualifying child for certain tax benefits, including the EIC. Review this information in the Volunteer Resource Guide (Tab C), Exemptions/Dependency, Qualifying Child of More than One Person.

In other words, Robyn's mother cannot use Aiden to claim Head of Household status and also let Robyn use Aiden to claim the EIC. In this example, Aiden can only be used on one tax return for multiple tax benefits, such as EIC, Head of Household filing status, dependency exemption, etc.

If Robyn and her mother cannot agree on who should claim the child, Robyn would be entitled to the credit, based on the IRS tie-breaker rules.

### What are the IRS tie-breaker rules?

When two taxpayers claim the same child for Earned Income Credit and other tax benefits on their returns, the IRS will apply the tie-breaker rule. Review the tie-breaker rules in the Volunteer Resource Guide (Tab H).



For EIC purposes, a qualifying child does not have to be the taxpayer's dependent unless the child is married. For example, the custodial parent (the parent the child lived with for more than half the year) can qualify for the EIC. The noncustodial parent cannot qualify for EIC because the child did not live with that parent for more than half of the year. It does not matter that the custodial parent does not claim the dependency exemption for the child in the case of divorced or separated parents.



**TaxWise Hint:** If there is the slightest chance the child will be a qualifying child for EIC purposes, be sure to check the EIC box next to the child's name on the Main Information Sheet. If they do not qualify, TaxWise will not allow the EIC.



List the children from youngest to oldest in the software.



## What are the rules for taxpayers without Qualifying Children?

Taxpayers can file Form 1040EZ, Form 1040A, or Form 1040 to claim the EIC without a qualifying child. Review the rules in the Volunteer Resource Guide (Tab H), under Part C Rules, If you do not have a Qualifying Child.

### TIP

Review the question on the approved intake and interview sheet: Could you or your spouse be claimed as a dependent on the income tax return of any other person (for 2008)? Did the taxpayer check this box?

### example

Tom and Martha are a married couple. Tom is 66 and Martha is 58 years old. If all other rules are met, they would qualify for the EIC.

### TIP

For a couple filing a joint return, only one taxpayer has to meet the age requirement.



## EXERCISES (continued)

Using the Interview Tips in the Volunteer Resource Guide, determine if each of these taxpayers has a qualifying child or can claim the EIC. Each child has a valid social security number.

**Question 3:** Maureen's 20-year-old daughter, Angie, lived with her for eight months of the year. Angie is not married and is a full-time college student. Is Angie a qualifying child for the EIC? ☐ Yes ☐ No

**Question 4:** Starting in February of the tax year, Sam has cared for Lisa, the 10-year-old daughter of his stepson. Does Lisa meet the EIC requirements for a qualifying child? ☐ Yes ☐ No

**Question 5:** Three children live with Mira, who cares for them as her own: Twila, the 3-year-old daughter of Mira's cousin; Chez, Mira's newly adopted 2-year-old son from Europe, who has lived with Mira since November of the tax year; and Dwight, Mira's 20-year-old son, who attends community college part time. Which of them are qualifying children? ☐ Twila ☐ Chez ☐ Dwight ☐ None

**Question 6:** A married couple is filing jointly. They are raising their 10-year-old granddaughter because their daughter is serving a long prison term. They are also caring for an unrelated 8-year-old boy who was placed with them as a foster child by the State Department for Family and Dependent Children. They have wages and an AGI of \$37,400. Assuming they meet all other tests, can they claim the EIC? ☐ Yes ☐ No

**Question 7:** Imagine that the married couple in the previous question was in a different situation: What if they were only caring for their granddaughter? Would they be able to claim the EIC? ☐ Yes ☐ No



## EXERCISES (continued)

**Question 8:** Margie's daughter, Aimee, turned 23 early in the tax year while attending college full time. Margie is filing as Head of Household. Margie has an AGI of \$29,231. Assuming that she and her daughter pass all other tests, can Margie claim the EIC? ☐ Yes ☐ No

**Question 9:** Rob and Laura are divorced. Laura is the custodial parent for Dawn, who lived with her all year. Laura signed Form 8332, allowing Rob to claim the dependency exemption for Dawn until she turns 18. Can Rob claim Dawn for the EIC? ☐ Yes ☐ No

Now that you have a foundation to answer the question, Who qualifies for the EIC?, let's go back to the approved intake and interview sheet.

The approved intake and interview sheet asks a taxpayer if they were previously disallowed the EIC. If the taxpayer answers "yes," make sure that he didn't answer "yes" just because their EIC was decreased or increased because of an error on their return.



Special rules apply if the taxpayer was previously denied EIC. See the Volunteer Resource Guide (Tab H), Disallowance of the Earned Income Credit.

***How do I answer the question, "Based on the interview, is the taxpayer qualified for the EIC?"***

You answer this question after you have collected all the facts using the Interview Tips in the Volunteer Resource Guide (Tab H).

### ***Optional Class Exercise***

Mark and Evelyn Bell are married and file a joint return. They have an 8-year-old child, Jennifer Bell, who lived with them the entire year and whom they claim as a dependent. The Bells have adjusted gross income of \$21,250, which consists of wages of \$21,211 and interest income of \$39.

You have already verified their identities and social security information. Mark and Evelyn are both age 32 and no one is permanently and totally disabled.

Do Mark and Evelyn qualify for the EIC? ☐ Yes ☐ No

## **How is the correct Earned Income Credit amount calculated?**

The credit is determined using worksheets and the Earned Income Credit tables.

You will already have determined if your taxpayer qualifies for the EIC from the information you gathered to answer questions on the approved intake and interview sheet.

The EIC worksheets can be found in Form 1040, 1040A or 1040EZ Instructions. Every tax preparer or their site should have at least one set of instruction booklets.

## Combat Pay Election

If a taxpayer has combat pay listed in box 12 of Form W-2 marked with code Q, and you are preparing a paper return, you may need to prepare two EIC worksheets to determine if the combat pay should or should not be added to your taxpayer's income.

If this election is chosen, write the combat pay amount by the EIC line of the payment section of the tax return. You can see this entry in the Volunteer Resource Guide (Tab 6), see Form 1040 – Other Taxes and Payments.

## Where are the EIC tables and how do I use them?

The EIC tables are located in the appendix of Publication 4491-W. Additional tables are in Publication 596, Form 1040 and Form 1040A. The Form 1040EZ Instructions only contain information for taxpayers with no children.

Let's look at those tables now. Turn to the first page of the EIC tables.



Double-check that the heading on your page says "Earned Income Credit (EIC) Table." It is common to mistake the Tax Tables for the Earned Income Credit tables.

### Class Exercise

A taxpayer is filing Head of Household and has one qualifying child. The earned income and AGI is \$19,000. How much is the EIC this person is entitled to?

Notice at the top of the table you find your amount in the "At least - But less than" column. Then go across and find the correct filing status column: Single, Head of Household and Qualifying Widow(er), or in a separate column, Married Filing Jointly. Sub-columns break it down to "No children, One child and Two children." The EIC should be \$2,392. If you didn't get this answer, try again.

You would enter the amount on the Earned Income Credit line in the Payments section of the return.

## How do I compute the Earned Income Credit using TaxWise?

Using TaxWise simplifies the EIC calculations. However, you have to pay attention when you start filling in the Main Information Sheet after you have interviewed the taxpayer.

On the Main Information Sheet, you will come to a section titled "Dependents/Nondependents."

If there is the slightest chance the taxpayer will qualify for the Earned Income Credit, check the EIC box following the name on the Main Information Sheet. If later the taxpayer is found not to qualify, the software will not allow the EIC. Review this sheet in the Volunteer Resource Guide (Tab 1).

When you are almost done with the return and get to the EIC line in the Payments section, link to the worksheet for Schedule EIC and proceed to answer the questions in red. Many of the questions are already answered based on information from the return. You covered them when you answered questions on the approved intake and interview sheet.



**TaxWise Hint:** As with any form, read and answer the questions carefully!

Always, double check that there are no red checkmarks by Schedule EIC or the Schedule EIC Worksheet on the forms tree. If there are, go back to the form and correct the situation.

If the taxpayer has had their EIC previously denied, you will need to fill out Form 8862 in TaxWise.

Usually, TaxWise completes Schedule EIC automatically. However, if a qualifying child is 19 or older, you will have to answer the question on Schedule EIC relating to whether the child was under 24 and a full time student or if the child was totally and permanently disabled regardless of age. On Schedule EIC, check the second box only if the answer to the first question is "No."

On Schedule EIC in TaxWise, if a taxpayer seems to qualify for the EIC, but does not qualify, check the "No" box at the top of the screen.

TaxWise automatically computes the EIC based on the information you enter.

### **Combat pay**

As long as you correctly entered the combat pay reported on Form W-2 in box 12, code Q and the taxpayer qualifies for the EIC, TaxWise will determine if it is better to include the combat pay for EIC purposes or not. TaxWise enters the credit on the EIC line in the Payments section of the tax return. If the EIC entry does not match your expectations or that of the taxpayer, go back and verify your entries on the Main Information Sheet, on the EIC worksheet, and Schedule EIC.

### ***Advance EIC in box 9 of Form W-2***

Remember, this is an advance payment of the Earned Income Credit. It must be accounted for on the tax return. As long as you correctly entered all the entries on the W-2 into the software program, TaxWise will enter this amount in the Other Taxes section of Form 1040.

### **Do I need to attach Schedule EIC or the Schedule EIC worksheets to the return?**

If the taxpayer has at least one qualifying child, complete Schedule EIC, Earned Income Credit Qualifying Child Information, and attach it to the tax return. Taxpayers with no children make a direct entry on the EIC line.

TaxWise will print Schedule EIC to be attached to the taxpayer's copy of the return. If you are not using a software program, be sure to attach Schedule EIC to the taxpayer's return and give them a copy also.

Do not attach the worksheets to the return. Give them to the taxpayer with his/her copy of the return.

## Practice – Vanessa Franklin

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Take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-37 and review the sample interviews with Vanessa related to this lesson. You will also find an optional exercise of completing her EIC worksheet.

## Summary

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The Earned Income Credit computation is based on filing status, number of qualifying children (1-2), earned income, and adjusted gross income. Certain individuals with no children may also qualify.

By using the approved intake and interview sheet, the Interview Tips in the Volunteer Resource Guide and correctly filling out the EIC worksheets, most of the errors that arrive from incorrectly computing the EIC can be avoided.

Taxpayers who received advance EIC payments will have the amount entered in box 9 of their Form W-2. They are required to file a tax return.

The EIC is entered in the Payments section of the return. See Vanessa's completed worksheets in Appendix B.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



**Answer 9:** No. While Rob can claim his daughter as a dependent, the daughter did not live with him for more than half the year, so she fails the residency test. Dawn is the qualifying child of Laura. If you are filing a paper return, be sure to write Dawn's information on Schedule EIC.

[illegible]



### Introduction

This lesson will help you identify whether the taxpayer has a refund or an amount due. The taxpayer's refund and amount owed are reported on Form 1040, page 2, in the Refund and Amount You Owe sections of the tax return. This part of the return represents a summary of the tax, credits, and payments.

### Objectives

At the end of this lesson, using your resources materials, you will be able to:

- Identify the applicable section and lines of Form 1040 for the refund or amount owed
- Report the correct amount of refund or amount owed
- Identify the refund options available
- Describe the different payment options for the amount owed
- Identify the Third Party Designee portion of the tax return and determine its purpose

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 1040
- ☐ Form 8888
- ☐ Form 9465
- ☐ **Optional:** Publication 594

### How do I know if the taxpayer is due a refund?

The taxpayer's total tax appears on line 61 of Form 1040.

The taxpayer's total tax payments already made, which includes refundable credits, appears on line 71 of Form 1040.

If the payments made exceed the amount of tax liability, the amount of the overpayment is shown on line 72 (line 71 minus line 61).

### What are the options for an overpayment?

Taxpayers can choose to:

- Apply any portion of their overpayment to the following tax year
- Receive their refund using direct deposit
- Receive their refund as a check

#### ***How do I apply part of the overpayment to the following year?***

For taxpayers who want to apply a portion of the overpayment to next year's taxes, enter the amount to be applied to the following year directly on line 74.





**TaxWise Hint:** TaxWise shows the remaining amount to be refunded to the taxpayer on the amount to be refunded line.

***How do I indicate that the entire refund should be sent to the taxpayer?***

For taxpayers who want the entire refund sent to them:

- Leave line 74 blank or enter "0"
- TaxWise shows the entire refund amount on the amount to be refunded line

Refund checks are usually mailed within 6-8 weeks after the return is filed. However, instead of getting a paper check, taxpayers may choose to have their refund deposited directly into their account at a bank, credit union, or other financial institution. In addition, taxpayers can request that their refund be deposited directly into a TreasuryDirect online account to buy U.S. Treasury marketable securities and savings bonds. Details can be found at [www.treasurydirect.gov](http://www.treasurydirect.gov).

Encourage taxpayers to use direct deposit, which is much faster, safer, and more efficient. With an e-filed return, a direct deposit is usually received within 10-14 days.

***How do I enter the information for direct deposit?***

To have the refund deposited into a single account, enter the routing transit number (RTN) and depositor account number (DAN) in the TaxWise Main Information Sheet's "Bank Account Information" section. Make sure the taxpayer shows you proof of this bank information. Bank deposit slips are not a reliable source for routing and account numbers for direct deposit.

Go to the Volunteer Resource Guide (Tab 13) and find pointers for direct deposit of refunds, including a diagram showing where to find the RTN and DAN information on a check.



**TaxWise Hint:** You are required to re-enter the RTN and DAN information, including account type (checking or savings) on page 2 of TaxWise Form 1040, on the line for direct deposit. This gives TaxWise an opportunity to make sure the information was entered properly. If the information does not match, TaxWise will give you a warning when you run diagnostics during the completion phase of the return.



If the routing and account numbers are not valid, the refund will be delayed 4-6 weeks. If the direct deposit is rejected, a paper check will automatically be mailed to the address on the return.

***Can the refund be deposited into more than one account?***

Taxpayers can choose to divide their direct deposit refund among up to three accounts. For example, a person expecting a refund of \$500 could choose to deposit \$200 into a checking account, \$200 into a savings account, and \$100 into an IRA account. Use Form 8888, Direct Deposit of Refund to More Than One Account, to list the RTN and account number for each deposit. Form 8888 is not required if the refund is to be deposited into a single account. If Form 8888 is used, no bank account information should be entered on the Main Information Sheet or Form 1040, page 2.

## What if the taxpayer makes a mistake on the return that increases the amount of the refund?

The IRS recommends using electronic filing to avoid math errors and other common problems that can require adjustments to a return after it is filed. If an adjustment results in a larger refund than expected, the IRS adds the difference to the last account designated for direct deposit.



When an adjustment is made to a tax refund, the IRS sends a letter explaining any error(s) that resulted in the adjustment, as well as any changes made to the refund amount and the amount of each direct deposit.

## What if the taxpayer makes a mistake on the return that decreases the amount of the refund?

If an adjustment results in a smaller than expected refund, the IRS uses a bottom-up rule and deducts the difference from the direct deposit amount designated for the last account shown on Form 8888. If the difference exceeds the amount designated for the last account, the IRS deducts the remainder from the amount designated to the next account, etc.

### example

Joan's return shows a refund of \$300 and she asks the IRS to split her refund among three accounts with \$100 to each account. Due to an error, her refund is decreased by \$150. The IRS will adjust her direct deposits as follows:

	Requested Direct Deposits	Actual Direct Deposits
Account 1	\$100	\$100
Account 2	\$100	\$50
Account 3	\$100	\$0

The IRS will apply this same bottom-up rule to adjust direct deposits for refund offsets for *unpaid federal taxes* or if the *Earned Income Credit (EIC) portion of the taxpayer's refund* is withheld pending further review. After the EIC review, if a refund is allowed, it will be direct-deposited in the account listed first on Form 8888.

### example

Bill asks that his refund of \$780 be deposited into 3 different accounts: \$300 into Account 1, \$300 into Account 2 and \$180 into Account 3. However, Bill owes federal taxes of \$290 on an earlier tax year, and after this is offset only \$490 remains to be direct deposited. Account 3 will receive \$0, Account 2 will receive \$190 and Account 1 will receive \$300.

## What happens if the taxpayer owes other debts like student loans or child support?

If the refund is decreased due to an offset to pay state income tax, child support, or certain federal nontax debts, such as student loans, then the decrease will be taken first from the payment that appears first on the payment file received from the IRS. (The IRS payment file orders accounts from the lowest to the highest routing number.) If the debt exceeds the payment designated for the account that appears first on the payment file, Financial Management Service, (FMS) will reduce the payment designated for the account that appears next.

### What should I watch out for?

Double-check the RTN of the financial institution before the return is transmitted if:

- You are unfamiliar with the financial institution.
- The RTN is for a credit union that is payable through another financial institution. The taxpayer should contact their credit union for the correct RTN.
- If more than one account is selected for direct deposit, be sure that the amounts on Form 8888 equal the refund amount on Form 1040.



Financial institutions generally disallow a joint refund to be deposited into an individual account. The IRS is not responsible if a financial institution refuses a direct deposit.



### EXERCISES

Answers follow the lesson summary.

**Question 1:** Although direct deposit saves postage, it is no faster than receiving a refund through the mail. ☐ True ☐ False

**Question 2:** When entering an account number for direct deposit, make sure to include all spaces and hyphens. ☐ True ☐ False

## How do I know if an amount is owed?

If the payment total is less than the amount of tax, then TaxWise:

- Shows the amount of tax owed on the Amount you owe line on Form 1040 (total tax minus total payments)
- Generates a copy of Form 1040-V, Payment Voucher

Explain to taxpayers that the tax return will be filed now and that they should submit their payment of taxes due no later than April 15.

## What forms of payment are acceptable?

The payment options are:

- Check or money order submitted with Form 1040-V, Payment Voucher
- Electronic funds withdrawal
- Credit card
- Electronic Federal Tax Payment System (EFTPS)



Explain to taxpayers who have an amount owed that the return must be filed by the due date even if the full amount cannot be paid. A separate penalty for filing a return after the due date may be applied.



**TaxWise Hint:** If you need the mailing addresses for Form 1040-V, open Form 1040-V, then click on TaxWise help and follow the instructions.

Go to the Volunteer Resource Guide (Tab 13), Finishing the Return, to review the information on balance due returns. Be sure you read this reference and refer to it when you prepare a return that has an amount owed.



**TaxWise Hint:** If using Electronic Funds Withdrawal, at the bottom of page 2 of the TaxWise Form 1040, indicate that the taxpayer wants to pay all or part of their taxes electronically. Make sure the appropriate information is filled in on the TaxWise Form ACH 1040/ES Direct Debit for Balance Due or Estimated Tax Payment and on the Main Information Sheet. Refer to Volunteer Resource Guide (Tab 6) for details.



The paper Form 1040-V includes instructions and a table of IRS Service Center addresses.



Taxpayers should not mail cash with their returns.

### What if the taxpayer cannot pay?

Taxpayers who cannot pay the full amount owed, shown on line 75 of their return, may request the following:

- Pay in full within 60 or 120 days with no fee; interest and penalty charged on payments after April 15
- Make monthly installment payments by filing Form 9465, Installment Agreement Request

### Form 9465, Installment Agreement Request

- When filing a paper return, Form 9465 should be completed and attached to the front of the return before mailing.
- If the return is being filed electronically, Form 9465 can also be included in the e-filed return.
- If the request is granted, the taxpayer must also pay a fee of \$105 or \$52, if payments are made by electronic funds withdrawal. If the taxpayer's income is below certain limits, they can request a reduced user fee of \$43 by completing Form 13844, Application for Reduced User Fee for Installment Agreement. Taxpayers can obtain Form 13844 at [www.irs.gov](http://www.irs.gov) or by calling the IRS forms number at 1-800-829-3676.
- The taxpayer can also file an Online Payment Agreement Application (OPA) at the IRS web page. For more information, go to [www.irs.gov](http://www.irs.gov) and search for the term "OPA" or, on the "I need to..." list, click "Set Up a Payment Plan."



**TaxWise Hint:** You may select Form 9465 by clicking on the Add Form/Display Form List tab. On the form, electronic funds withdrawal may be selected for the taxpayer's payment. If this option is selected, you will need to enter the account information on both Form 9465 and on the Main Information Sheet.



## EXERCISES (continued)

**Question 3:** For which of the following will the taxpayer be charged a convenience fee?

- A. Direct deposit of a refund
- B. Electronic funds withdrawal of a tax payment
- C. Using a credit card to make a tax payment
- D. Using a personal check to make a tax payment

### Taxpayer Example

Seymour's paper Form 1040 shows his total tax is \$450 (line 61). His tax payments come to just \$200 (line 71). Therefore, Seymour owes \$250 (line 75).

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*The amount of tax you owe for 2008 is \$250. You can either mail in a check or money order with the payment voucher, use electronic funds withdrawal, or call in a credit card payment. You'll have to pay an additional convenience fee for using a credit card.*

*No, we can designate the date that the debit will occur, any time up to April 15. I would just need to see proof of account to verify your bank account information so I can include the routing and account numbers in your electronic return.*

*Right. And it saves you the trouble of mailing in the voucher with your payment.*

*You can do that too. Here's Form 1040-V, which has been completed for you. Make your check or money order payable to "United States Treasury." If it's not already printed on the check, make sure it shows your name, address and daytime phone number. Also, print your social security number and "2008 Form 1040" on the front of your check. Then mail the payment with the voucher. I'll get the mailing address for you.*

*Just make sure it gets postmarked no later than April 15. I can e-file your tax return right now, but it's up to you to make sure you send in your payment on time.*

##### SEYMOUR RESPONDS...

Hmm. How does electronic funds withdrawal work? Does it come out of my account right away?

And there's no charge?

Sounds good to me. But I don't have my checking account information with me. Maybe I should just mail in my payment.

That doesn't seem too hard.

## How is the estimated tax penalty calculated?

The estimated tax penalty is calculated on Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, and reported on line 76 of Form 1040. While completion of Form 2210 is out of the scope of the VITA/TCE program, it is important for volunteers to have an awareness of the estimated tax penalty provisions.

### What is the Estimated Tax Penalty?

Taxpayers may owe a penalty for underpayment of estimated tax if they did not pay enough tax, either through withholding or by making estimated tax payments. A penalty may apply if the tax owed is:

- \$1,000 or more, and
- More than 10% of the total tax liability shown on the return

Taxpayers who did not make sufficient estimated tax payments for the year may also owe the penalty.

There are special situations when a taxpayer will not have to pay a penalty. If the total of the taxpayer's withholding and estimated tax payments was at least as much as the prior year's tax, then the penalty may not apply. See Publication 17 for more information.

#### example

Mark had \$417 in withholding. He did not have enough taxes taken out of his paycheck and he owes \$1,240 in income taxes, shown on line 75 of his tax return. His total tax was \$1,657, shown on line 61. \$1,240 is more than \$1,000, and certainly more than 10% of \$1,657. Mark will probably need to pay a penalty for underpayment of estimated tax.

### Do I have to calculate the tax penalty?

Because Form 2210 is complicated, leave line 76, Form 1040 blank. This will not prevent the IRS from calculating the penalty if it is due. Let the taxpayer know that a penalty may be owed, and if so, the IRS will send a notice. If necessary, the taxpayer can complete the Form 2210 that will be included with the notice.



**TaxWise Hint:** For 2008, Form 2210 will be defaulted in TaxWise and \$0 will be reflected on line 9. This will prevent volunteer preparers from calculating the estimated tax penalty. Volunteer preparers need to inform taxpayers with a balance due who are meeting the estimated penalty requirements that they may receive a notice from the IRS.



### EXERCISES (continued)

**Question 4:** Dion's total tax liability on Line 61 is \$1,044. After withholding, she owes \$640. This means Dion might have to pay a penalty for underpayment of estimated tax. ☐ True ☐ False

## What is the Third Party Designee?

For taxpayers who want to allow a friend, family member, or another person to discuss their 2008 tax return with the IRS, the “Yes” box of the Third Party Designee area of the return can be checked. You may see this situation in the case of an individual going overseas, or elderly parents who wish to have their adult child handle their affairs. You will also need to enter the name, phone number, and any five numbers the designee chooses as their personal identification number (PIN).

The image shows a portion of a tax form with a diagonal line drawn through it. The visible text includes: "You Owe", "Estimated tax penalty (see instructions)", "Third Party Designee", "Do you want to allow another person to discuss your tax return with the IRS?", "Designee's name", and "Under penalties of perjury, I declare that I know and am authorized to designate this person as my third-party designee."



Volunteer preparers may *not* be designated as a “Third Party Designee.”



See Publication 17 for information on what the taxpayer is authorizing when designating a third-party designee.

## How can I avoid common errors?

Double- and triple-check the routing number and account numbers for direct deposit and electronic funds withdrawal. Have the taxpayer compare the numbers to their check or account card. If an error is made in the bank information, the taxpayer must work with the bank to resolve any misdirected funds.

## Practice – Vanessa Franklin



Let's see how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-45 and review the sample interview with Vanessa related to Lesson 31.

Return to this lesson after you have reviewed this information.

## Summary

### Refunds

If the payments made exceed the amount of tax, then the amount of the overpayment is entered on line 72 of Form 1040.

Taxpayers can choose to apply any portion of their overpayment to the following tax year, or receive their refund as a check or direct deposit. Direct deposits can be split among as many as three different accounts by using Form 8888.

For direct deposit of the refund, enter the routing transit number (RTN) and depositor account number (DAN) on the TaxWise Main Information Sheet and page 2 of Form 1040. Use a check as proof of account. When the return is printed, this information will appear on lines 73b through 73d of Form 1040.



## Amount Owed

If the payment total is less than the amount of tax owed, then TaxWise shows the amount of tax owed on line 75 of Form 1040 and generates a copy of Form 1040-V, Payment Voucher, which is used for mail-in tax payments.

Explain to taxpayers that the tax return can be electronically filed now but that they must submit their payment of taxes due no later than April 15, 2009. They can pay with a check or money order, with Form 1040-V, electronic funds withdrawal, or a credit card.

If taxpayers are unable to pay, they may request an installment agreement by submitting Form 9465. This can be done with the return, whether filed electronically or on paper. Taxpayers can also use the Online Payment Agreement feature on [www.irs.gov](http://www.irs.gov).

Interest and penalty is charged on amounts not paid by the due date. There are fees associated with certain payment options.

## Estimated Tax Penalty

If it appears the taxpayer owes an estimated tax penalty, advise the taxpayer that the IRS will calculate the penalty and send a bill.

## Third Party Designee

Taxpayers can authorize a friend, family member, or another person (besides the volunteer) to discuss their return with the IRS. Volunteers should *never* designate themselves as a Third Party Designee.



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and complete the Comprehensive Problem for your course of study:

1. Basic - Bennett
2. Intermediate - Yale
3. Advanced - Dalhart
4. Military - Sierra
5. International - Holmes



### EXERCISE ANSWERS

**Answer 1:** False. Taxpayers will receive their refund faster if they use direct deposit.

**Answer 2:** False. Enter the account number from left to right, leaving out all spaces and special characters.

**Answer 3:** C. The credit card processor covers its costs by assessing a “convenience fee” to taxpayers using this system. Taxpayers will be advised of the amount of this fee when they call the interactive voice response system.

**Answer 4:** No. The tax Dion owes is less than \$1,000, so she does not have to pay a penalty.



## This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



### Introduction

The goal of VITA/TCE is to provide high-quality service. The purpose of a quality review is to ensure that the tax return has been completed accurately based on the supporting documents provided by the taxpayer, and the completed Form 13614-C, Intake/Interview & Quality Review Sheet or approved alternative form.

Sites may have various methods for conducting quality reviews. For example, some may use an approved intake and interview form other than Form 13614-C; instead of using the quality review sheet that is part of that form, these sites may use Form 8158, Quality Review Sheet, or an approved alternative.

As a volunteer tax preparer, you must do your part by ensuring that every return you prepare receives a quality review. Accurate tax returns result in fewer error notices from the IRS and ensure correct amounts for taxes owed or refunds due and refunds arriving more quickly.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Perform the final steps for completing a return in TaxWise
- Identify the three methods of quality review
- Perform a quality review using an approved Quality Review Sheet
- Use the TaxWise Tax Summary Sheet during the quality review (if your site uses TaxWise software)

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Approved Quality Review Sheet
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 8879

#### **Optional:**

- ☐ Form 8283
- ☐ Form 8332
- ☐ Form 8453

### How is a quality review of a return completed?

All tax returns prepared at volunteer tax preparation sites must be quality reviewed. The preferred method is to review a paper copy of the tax return, along with all source documents, even if the return was prepared electronically.

This lesson will explain the steps involved in the quality review process for federal tax returns. To perform a quality review of a tax return, use Form 8158, Quality Review Sheet or an approved alternative, and the tools in Publication 4012, Volunteer Resource Guide.

Depending on the site, one of three methods of quality review may be used:



Volunteers should always review their work, even if it is to be reviewed by another party.

- An experienced designated reviewer (designated quality reviewer)—the preferred method
- Preparers review each other's work (peer review)
- Volunteers review their own work (self-review)

The approved quality review sheet is a list of items that must be verified when reviewing tax forms. Reviewing these items prevents common errors from occurring, such as overlooking credits or income, or entering an incorrect social security number.

## How do I conduct a quality review of a return?

First, verify that the approved intake and interview sheet is complete, consistent, and accurate. Then proceed with reviewing the return. This year the IRS combined the Intake and Interview Sheet and the Quality Review Sheet into one form: Form 13614-C, Intake/Interview & Quality Review. Form 8158, Quality Review Sheet, can still be ordered as a separate form, but the IRS intake sheet only comes in this format. Perform the review with the taxpayer immediately after completing the return and before the taxpayer signs it. Simply compare the questions on the approved quality review sheet with the information shown in the return. Use the following suggestions to complete your review:

- **Identity:** Have the taxpayer verify that the name, date of birth, SSN, and address are correct.
- **Filing Status:** Have the taxpayer verify that the filing status is correct. Did you ask all the questions to determine this correctly?
- **Exemptions:** Verify that the dependents claimed meet the tests to qualify.
- **Income:** Verify that the taxpayer's wages are accurate and that all income from Form(s) W-2 and other income documents, such as Form(s) 1099, have been included. Make sure that all the Form(s) W-2 are attached.
- **Adjusted Gross Income, Tax and Credits, and Other Taxes:** Verify that all adjustments, deductions, and credits are supported by the taxpayer's documentation and that all of the adjustments, deductions, and credits noted on the approved intake and interview sheet have been addressed.
- **Payments:** Verify that the tax withheld from Form(s) W-2 and other source documents has been included and added correctly. Make sure that all Form(s) W-2G and Form(s) 1099 are attached if tax was withheld.
- **Refund and Amount You Owe:** Check that the direct deposit information is correct. Did you explain to the taxpayer how to pay a tax due?
- **Sign Here:** Remind the taxpayer to sign and date the appropriate forms based on the filing method (e-file or paper prepared) used at the site. For joint returns, both spouses must sign the documents.



Check returns for accuracy – review social security numbers, double-check math, verify amounts transferred from schedules and tax tables.



Always include the taxpayer in the quality review process.

- **Paid Preparer's Use Only:** Make sure the correct Site Identification Number (SIDN) is entered. The SIDN is the letter "S" followed by an eight-digit site identification number that represents your particular site. For more information on SIDNs, see: *Do I have to enter a site number?* in this lesson.

### **How do I use the TaxWise Tax Return Summary screen?**

Review the highlights of the summary with the taxpayer, focusing on the areas discussed above.

If you find errors on the Tax Return Summary screen, you will be able to correct them when you run a diagnostic on the return (discussed below).

### **What do I need to check?**

Use a printed version of an approved quality review sheet to review the tax return. Check each appropriate box as you verify each question or leave it blank if the item does not apply to the tax return. If items are incorrect or incomplete, ensure that corrections are made to the return.

#### ***If errors are identified***

- Make necessary changes on the tax return and notate the approved intake and interview sheet
- Perform another quality review based on site procedures

#### ***When the return is error-free***

- Return is ready for the **taxpayers signature(s)** based on the completed review.

### **How do I complete the Sign Here section of a paper Form 1040?**

---

Taxpayers who file paper returns must sign and date the return in the Sign Here section of Form 1040. **A return is not considered to be valid, and refunds are not issued, unless the return is signed.**

The Volunteer Resource Guide has complete instructions on signature procedures for different types of situations. Please review the Finishing the Return (Tab 13) in the Volunteer Resource Guide. Publication 17, Your Federal Income Tax for Individuals, filing information also contains information on signature processes.

### **Do I have to enter a site number?**

---

Volunteers should ensure that the site's identification number (SIDN) has been entered in the box "Preparer's SSN or PTIN." **Do not complete any other information in the Paid Preparer's Use Only section.**

### **What is the purpose of the site number?**

The IRS captures a wide range of important statistical information from tax returns, including which returns were prepared at VITA/TCE tax preparation sites. Therefore, it is important that all returns be identified with the site identification number.

## Where do I get the site number?

Many VITA/TCE tax preparation sites provide you with paper return forms that are pre-printed with the site's identification number (SIDN), which is an eight-digit figure starting with the letter "S," in the Paid Preparer Section of the return. Some sites may provide labels or stamps with the SIDN.

If your site does not use forms with the pre-printed SIDN, you must print your site's entire identification number in the Preparer's SSN or PTIN field. At sites using tax preparation software such as TaxWise, the software is usually programmed to automatically enter this information on each return.

The image shows the 'Paid Preparer's Use Only' section of a Form 1040 (2008). The section includes fields for the spouse's signature, date, and occupation; the preparer's signature, date, and SSN or PTIN (pre-filled with S15011111); and the firm's name, address, EIN, and phone number. A note at the bottom indicates the form is printed on recycled paper.

Keep a copy for your records.	Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	
	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN <b>S15011111</b>
<b>Paid Preparer's Use Only</b>	Firm's name (or yours if self-employed), address, and ZIP code	EIN	Phone no.	

Form **1040** (2008)  
Printed on recycled paper

Once you have obtained the taxpayer's signature and entered the SIDN, you are ready to assemble the return. Refer to Lesson 33, Concluding the Interview for these steps.



### EXERCISES

Answers follow the lesson summary.

**Question 1:** A joint return requires the signature of:

- A. At least one spouse
- B. Both spouses
- C. The spouse with the highest income

**Question 2:** What is the form number of the IRS quality review sheet used by most volunteers for quality review?

## How do taxpayers sign an e-file return?

All electronically filed returns will use the Self-Select PIN or Practitioner PIN method to sign the tax returns. When you have verified that the taxpayer's information is correct on the Tax Return Summary screen, you are ready to obtain the taxpayer's electronic signature. Taxpayers who are filing electronic returns may use one of two methods to sign their return. Depending on your sites procedures, taxpayers can use a Self-Select PIN to sign their return or the Practitioner PIN method.

The Self-Select PIN allows taxpayers to electronically sign their e-file return by entering a five-digit PIN into TaxWise. The PIN is any five numbers a taxpayer chooses to enter as their electronic signature. (A convenient suggestion is to use their ZIP code.) The number cannot begin with zeros or be all zeros. Taxpayers do not need to register the PIN with the



The tax return should be completed before deciding to use the Self-Select PIN program.

IRS before e-filing nor contact the IRS to get one. Taxpayers need not memorize the number but may want to record it if they plan to use the Self-Selected PIN when e-filing next year.

### Who can use a Self-Select PIN?

To be eligible, taxpayers must have a copy of their previous year's tax return so that you can verify their identity and enter their adjusted gross income (AGI) for the 2007 tax year into TaxWise. Taxpayers may elect to use their prior year PIN for authentication in lieu of their prior year AGI.

If you are filing a return that requires attachments other than Form W-2, Form W-2G, or Form 1099-R, Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file return is used only to transmit supporting paper documents to the IRS. For example:

- Form 2848, Power of Attorney
- Form 8332, Release of Claim to Exemption for Children of Divorced or Separated Parents

### Can taxpayers who file joint returns use the PIN?

Both spouses must be present to file if they plan to use the Self-Select PIN.

Review the Self-Select PIN process in the Volunteer Resource Guide (Tab 13).



Use the Self-Select PIN only if the taxpayer brings in their previous year's return.

### How does the taxpayer create a Self-Select PIN?

Turn to the Self-Select PIN Guidelines in the Volunteer Resource Guide (Tab 13). After the return is completed, run an initial diagnostics to identify any errors. Return to the Main Information Sheet and see if the return qualifies for the Self-Select PIN. If the return qualifies and the taxpayer agrees to the electronic signature, complete the information on the Main Information Sheet.

At this point, TaxWise will verify all of the information and automatically fill in the line "Does this income tax return qualify to use a PIN?" Taxpayers who qualify for a PIN may now type their PIN number(s) into TaxWise using the keyboard. Put an "X" in the "I do not authorize" box, if it is not already set as a default. Now, you are ready to run diagnostics (see below).



You are not authorized to enter a PIN for taxpayers who choose to use the Self-Select PIN process. They must enter their PIN themselves using the keyboard.

### What is a Practitioner PIN?

The Practitioner PIN enables the tax preparer to sign the return on behalf of the taxpayer. The taxpayer(s) must give permission to the preparer to sign the return on Form 8879, IRS e-file Signature Authorization. More information is available in the Volunteer Resource Guide (Tab 13), Finishing the Return.

## How do I complete a return in TaxWise?

After the electronic return has been signed, you'll need to perform the following steps in TaxWise:

- Run diagnostics on the return
- Create the e-file
- Verify that the site number appears on the Main Information Sheet in TaxWise



Remind the taxpayer that, since they e-filed, they will not receive a tax package from the IRS next year.

Print the return and give it to the designated individual for the final quality review. Review the Volunteer Resource Guide (Tab 13), *Finishing the Return*.

## Do I have to enter the SIDN in TaxWise?

The SIDN should automatically appear on the Main Information Sheet in TaxWise and on Form 8879, if applicable. The SIDN shows in the Paid Preparers Use Only section at the bottom of Page 2 of the printed Form 1040. When TaxWise is initially installed on the computer(s) at your site, the SIDN is normally entered into the TaxWise defaults. However, it is common for the SIDN not to appear on both screens. If you notice this, manually enter the correct SIDN and inform your Site Coordinator, who can then go into the TaxWise defaults and add the SIDN. Any returns started from that point on will have the correct information.

## How do I run diagnostics?

To run diagnostics, select the Diagnostics button on the TaxWise main toolbar at the top of the TaxWise screen, or use a method listed in the TaxWise Hint below. A box pops up to show the diagnostic information. Review warnings to see if any changes are needed.

If there are any electronic filing errors, click on the red text that appears in the box to open the form where the error occurred, make corrections, and rerun diagnostics. Repeat this process ("get the red out") until there are no more errors.



**TaxWise Hint:** There are other ways to run diagnostics in TaxWise:

1. Hit the F10 key twice while you are in the return. The first F10 closes the form you are currently in, the second F10 runs diagnostics.
2. Right-click on the TaxWise screen and choose "Diagnostics."
3. Press Ctrl-D.

## How do I create the e-file?

When the return contains no electronic errors, the *e-file* button becomes available. Click the *e-file* button to create the IRS electronic return file. At this point, you can print the return for review by your Site Coordinator. If you change the return after you create the e-file, you will need to re-run diagnostics and select the *e-file* button again.

## How do I print the return?

To print the return, click the *Print* button on the main toolbar in TaxWise. Do not use the *Print* button while in the diagnostics screen; this will print only the diagnostics screen. Now you are ready to give the return to your Site Coordinator. If the Site Coordinator finds errors, correct them in TaxWise, rerun diagnostics, and re-create the e-file.

## What are the final steps in completing the return?

Once the tax return has gone through the established site quality review process, assemble the return and ensure that all necessary documentation is complete.

If the taxpayer has chosen not to use a Self-Select PIN, print two copies of Form 8879, and obtain the taxpayer's signatures. If the return is a joint return, make sure both signatures are included on the form, otherwise the return will not be electronically transmitted.



### EXERCISES (continued)

**Question 3:** Sandra, who is 17, is eligible to use a Self-Select PIN to sign her return in TaxWise, except that she did not file a tax return for the previous year. Can she still file an electronic tax return for 2008 tax year? ☐ Yes ☐ No

**Question 4:** What are the three methods of quality review?

## Practice - Vanessa Franklin



Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-47 and review the sample interview with Vanessa related to the quality review and e-filing. Return to this lesson after you have reviewed the sample interview.

## Summary

This lesson explained the steps involved in the quality review process for paper and electronic returns. To perform a quality review of a tax return, use Form 8158, Quality Review Sheet or an approved alternative and the tools in the Volunteer Resource Guide.

It may help to think of these questions in the approved Quality Review Sheet in terms of how they relate to sections of the tax return:

- *Identity Section:* Have the taxpayer verify that the name, date of birth, SSN, and address are correct.
- *Filing Status:* Have the taxpayer verify that the filing status is correct. Have you asked all the questions to determine this correctly?
- *Exemptions:* Verify that the dependents claimed meet the tests to qualify.
- *Income:* Verify that the taxpayer's wages are accurate and that all income from Form(s) W-2 and other income documents, such as Form(s) 1099, have been included. Make sure that all Form(s) W-2 are attached.
- *Adjusted Gross Income, Tax and Credits, and Other Taxes:* Verify that all adjustments, deductions, and credits are supported by the taxpayer's documentation and that all of the adjustments, deductions, and credits noted on the approved intake and interview sheet have been addressed.



- **Payments:** Verify that any withholding listed from Form(s) W-2 and other source documents has been included and added correctly. Make sure that all Form(s) W-2G and 1099 are attached if tax was withheld.
- **Refund and Amount You Owe** sections: Check that the direct deposit information is correct. Did you explain to the taxpayer how to pay taxes that are due?
- **Sign Here** section: Remind the taxpayer to sign and date the appropriate forms based on the filing method (e-file or paper-prepared) used at the site. For joint returns, both spouses must sign the documents.
- **Paid Preparer's Use Only** section: Make sure the correct Site Identification Number (SIDN) is entered. The SIDN is the letter "S" followed by an eight-digit site identification number that represents your particular site.

In addition, for electronic filing, you and/or the Site Coordinator should make sure that Forms 8879 are signed when the Practitioner PIN signature option is used. Use of the Self-Select PIN signature option does not require Forms 8879.



## EXERCISE ANSWERS

**Answer 1:** *B. Both spouses must sign a joint return, even if only one spouse had income.*

**Answer 2:** *Form 8158, Quality Review Sheet.*

**Answer 3:** *Yes. Sandra will need to enter zero ("0") for her prior year's AGI in order to use the Self-Select PIN, or she may sign Form 8879 in order to file her 2007 tax return electronically.*

**Answer 4:** *Designated quality reviewer (the preferred method), peer review, and self-review.*



### Introduction

In this lesson, you will receive insights and information for concluding your interview with the taxpayer.

Using the interview techniques and tools discussed in the Screening and Interviewing lesson, such as active listening and building rapport, share the following with the taxpayer:

- Which records/documentation they should keep and why
- What documentation about them is maintained at the site – why, how long, etc.
- What they need to know and do if they overpaid their taxes (i.e., refund due dates, increasing the number of exemptions on Form W-4 to avoid overpayments, etc.)
- What they need to know and do if they owe additional taxes (i.e., payment due dates and estimated tax payments, reducing the number of exemptions on Form W-4 to avoid additional payments, etc.)

These are important tasks to accomplish even after the tax return is complete, quality checked, and ready to file. The way that you conclude the interview can impact taxpayers' attitudes toward the taxpaying experience and their satisfaction with the volunteer tax return assistance program. It can also make next year's tax preparation easier for taxpayers.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

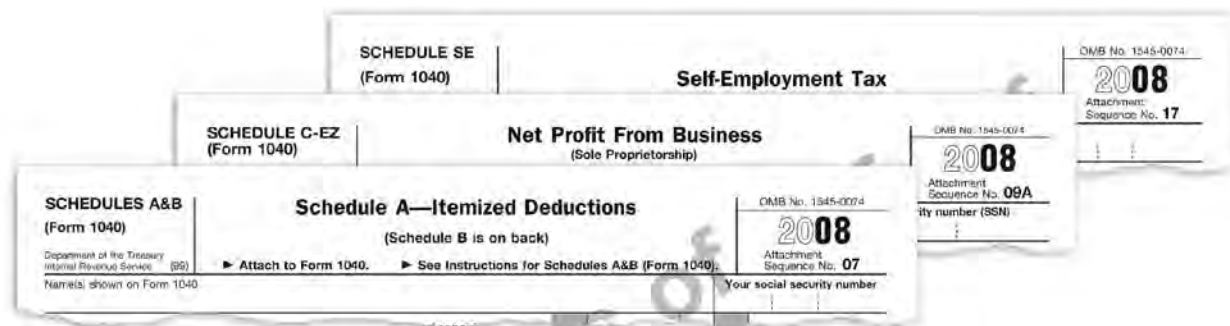
- Prepare the tax packet for filing
- Identify the records the site maintains
- Identify the records the taxpayer should maintain
- Estimate when refunds will be paid to the taxpayer
- Identify what taxpayers should do when they owe money and what they can do to avoid that situation in the future
- Identify how to adjust withholding
- Identify how and when a taxpayer can make estimated payments
- End the interview

#### What do I need?

- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Publication 730
- ☐ Form 1040-V
- ☐ Form 9465

#### **Optional:**

- ☐ Publication 505
- ☐ Publication 919
- ☐ Form 1040-ES
- ☐ Form 8332
- ☐ Form 8879
- ☐ Form W-4
- ☐ Form W-4P
- ☐ Form W-4V



## How do I prepare the packet for filing?

Most volunteer tax assistance sites use TaxWise software to create and e-file tax returns. Even so, taxpayers must retain paper copies of their returns. Follow the steps in the Volunteer Resource Guide (Tab B) to prepare the packet. In general:

1. Use TaxWise to print the entire return, including all forms, schedules, and attachments
2. Make sure the taxpayer(s) name(s) and social security number(s) are legible on every sheet
3. Assemble the packet:
  - Start with Form 1040 on top
  - Place each form, schedule, and attachment in the proper sequence, based on the sequence number shown in the upper right corner

## Who keeps the records?

### What forms should the taxpayer keep?

Advise the taxpayer to keep a copy of the following documents for at least three years:

- Form 1040 with all forms, schedules, and attachments
- All other tax-related documents, including Form(s) W-2 and Form(s) 1099
- If applicable:
  - Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents
  - Original Power of Attorney
- For e-file returns, the taxpayer must also keep a copy of the signed Form 8879, IRS e-file Signature Authorization. This form is not needed if the self-select personal identification number (PIN) is used.

If Publication 730, Important Tax Records Envelope, or an alternative is available, place the taxpayer's copies into that envelope.



Remind taxpayers to bring the envelope to the site with them next year.

## What tax return data will the site keep?

If a paper return is filed, the volunteer site will **not** keep copies of taxpayers' returns or any other taxpayer-related documentation. Taxpayers should keep copies of their records.

For e-file returns, the site will keep the following data confidential and in a secure location until December 31 of the current year, except as noted:

- A master backup disk containing all electronically transmitted returns
- One signed Form 8879 (which will be held for 3 years) for each return transmitted (unless Self-Select PIN procedures were followed)
- One copy of Form(s) W-2 and/or Form(s) 1099 showing federal tax withheld
- A copy of the IRS Acknowledgement Report for transmitted federal returns
- A copy of the Declaration Control Report (DCR) for transmitted returns may be kept

After the electronic return has been acknowledged, the Site Coordinator will store the taxpayers' information in a secured location.

### TIP

If your site does not have storage capability or will not be open after April 15th, make storage arrangements with your local IRS SPEC contact.

## What should I tell the taxpayer about refunds or balances due?

For taxpayers who are due a refund:

- Review the 2009 E-file Refund Cycle Chart in the Volunteer Resource Guide (Tab 14) and provide the expected date they may receive it. (The cycle chart will provide you with dates for direct deposit and paper checks).
- Make sure the taxpayer realizes that this is not a guaranteed date, since delays can occur.

For taxpayers who owe money to the IRS (also known as having a balance due):

- Remind them to send Form 1040-V to the appropriate address if they wish to mail a payment; for e-file returns, Form 1040-V, Payment Voucher, will be generated by the e-file software when the tax return results in a balance due.
- Electronic Funds Withdrawal can be set up to have payments electronically withdrawn from an account.
- Remind the taxpayer that payment must be made by April 15, 2009 to avoid penalties and interest.
- If the taxpayer is requesting an installment agreement, remind them to submit Form 9465, Installment Agreement Request, as soon as possible.
- If the taxpayer can pay a portion of the amount owed by the due date, they won't be charged interest and penalties on that portion.

## How can the taxpayer avoid a balance due next year?

---

There are several ways to pay taxes during the year in order to avoid having a balance due when the return is filed. Depending on the taxpayer's situation, you could suggest:

- For taxpayers whose income is mostly from wages or pensions, you can suggest that they adjust their withholding.
- If most income is from self-employment or investments, they should consider making or increasing their estimated payments.
- A combination of increased withholding and estimated tax payments may work best for some taxpayers.

## How can taxpayers adjust their withholding?

---

Taxpayers receiving wage income can adjust their withholding by providing their employer with a new Form W-4, Employee's Withholding Allowance Certificate.

By decreasing the number of allowances claimed on Form W-4, the amount withheld from each paycheck will increase.

To help taxpayers adjust their withholding using Form W-4, the IRS Web site provides a helpful withholding calculator at [www.irs.gov](http://www.irs.gov)—keyword: calculator. More information can be found in the Form W-4 Instructions, Publication 17, Tax Withholding and Estimated Taxes, or in Publication 919, How Do I Adjust My Tax Withholding?

Taxpayers can also use Form W-4 to request an additional dollar amount be withheld. Form W-4 can also be used to decrease the amount of tax withheld. This may be useful for taxpayers who received large refunds due to excessive withholding.

Withholding from pension income is voluntary, not automatic, as it is for wages. As a result, many retirees do not have tax withheld from their retirement payments and are unpleasantly surprised by a balance due at the end of the year. Taxpayers can request withholding from pension and annuity payments by submitting Form W-4P, Withholding Certificate for Pension and Annuity Payments to the payer.

Withholding can be requested from certain government payments, such as social security and unemployment compensation, by submitting Form W-4V, Voluntary Withholding Request to the paying agency.

## When should the taxpayer make estimated tax payments?

---

Estimated tax is the amount a taxpayer expects to owe for the tax year after deducting any tax credits or federal withholding. Taxpayers with significant income that is not subject to withholding (such as interest, dividends, capital gains or self-employment income) will often find they need to make estimated tax payments.

Estimated tax payments are generally required if both of the following conditions are met – the taxpayer expects:

1. To owe \$1,000 or more in tax after subtracting federal income tax withheld and credits from taxable income
- and**
2. The tax withheld and credits to be less than the smaller of:
  - a) 90% of the tax to be shown on their tax return for this year, or
  - b) 100% of the tax shown on their tax return for last year

The decision tree in Publication 17, Your Federal Income Tax for Individuals, Tax Withholding and Estimated Taxes can help determine if the taxpayer should make estimated tax payments.

#### example

Maria is retired, and her only income is from a pension and some investments. She had no withholding and is not eligible for any tax credits. Her tax last year, while she was still working full time, was \$2,760. When you complete her return this year, her tax totals \$1300. Maria should make estimated payments, since her tax after withholding and credits will be more than \$1000, and her withholding is less than \$1,170 (90% of this year's tax). If Maria doesn't want to make estimated payments, she could submit Form W-4P to request withholding from her pension instead.

## How is estimated tax figured?

Use Form 1040-ES, Estimated Tax for Individuals to compute the amount of estimated tax that should be paid over the year. This form includes worksheets to help the taxpayer estimate their income and tax liability for the year. The current year's tax return can be used as a starting point, but any anticipated changes should also be taken into account. Taxpayers may also have to adjust their payments during the tax year if a change in income or the tax law will affect their tax liability.

Estimated tax payments are due four times a year. If any due date falls on a Saturday, Sunday, or legal holiday, the payment is due the next business day. Each due date covers a specific time period:

For the period...	Due date:
January 1 through March 31	April 15
April 1 through May 31	June 15
June 1 through August 31	September 15
September 1 through December 31	January 15 next year

Most of the taxpayers you will assist will pay their estimated tax in four equal installments. However, a taxpayer can choose to make payments for each period based on the actual amount of income received during that period. If the taxpayer does not pay enough each payment period, they may be charged a penalty even if they are due to receive a refund when the tax return is filed. Generally, the simplest and safest procedure is to make sure that each payment is at least one-fourth of the prior year's total tax, less tax withheld during the period. For more information about estimated tax payments, refer to Publication 17, Tax Withholding and Estimated Taxes, or Publication 505, Tax Withholding and Estimated Tax.

## How is estimated tax paid?

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Estimated tax payments can be sent electronically to the IRS by direct debit payment from the taxpayer's checking or savings account, by credit card, or by check or money order with Form 1040-ES, payment voucher. Each voucher is numbered and inscribed with its due date. Remind taxpayers to be sure to use the correct voucher for each payment. Advise taxpayers to write their social security number and "2009 Form 1040-ES" on the check or money order payable to the "United States Treasury."

For more information, see the Form 1040-ES instructions.

## How do I close the contact?

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Before seeing the taxpayer off, show as much concern and interest as you did at the start of your time together:

- Explain what will happen next.
- Ask the taxpayer, "Do you have any questions before we say goodbye?"
- Advise the taxpayer how to get answers to questions that come up later.
- If the taxpayer seems interested in learning more about tax preparation, encourage them to consider volunteering. Provide them with contact information or take their contact information, depending on your site's procedures.
- Ensure that you have the contact information needed to reach the taxpayer in case there are any problems with the e-filing of the return.
- Thank the taxpayer for using the service.

## Does the taxpayer have to do anything else?

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If the return will be e-filed, give the taxpayer a brief explanation of how the process works:

- The Site Coordinator or designee will transmit all the e-file returns.
- The next day, the Site Coordinator or designee will receive an acknowledgement for each successful e-file, or a reject notice if there was a problem with the electronic file. The most common problem is a name or social security number that does not match IRS records.
- If the e-file is rejected, the Site Coordinator or designee may need to contact the taxpayer to resolve the problem.

If the return is not being e-filed, the taxpayer must mail the signed copy of the tax return, along with copy B of all Form(s) W-2, and one copy of any Form 1099 that shows federal withholding. The taxpayer will need another copy of the return and Form(s) W-2 if filing a state return. Make sure the taxpayer knows the correct address for mailing the return. Remind the taxpayer that the return must be postmarked by the filing deadline of April 15, 2009.

## Practice – Vanessa Franklin

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Let's conclude our interview with Vanessa. Go to Appendix A-48 and review the sample interview related to this lesson. Return to this lesson after you have reviewed this information.

## Summary

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Concluding the interview properly ensures that each taxpayer has a complete record of the return, understands what will happen next, and knows how to get answers to questions that come up later. If you handle the interview well, it can help taxpayers develop a more positive attitude toward the tax experience, which can foster greater accuracy in returns and timeliness in filing.

You should know how to assemble the tax packet and how to end the interview.

The taxpayer should leave with instructions on:

- What records the site is maintaining
- When (approximately) to expect the refund
- How to avoid having a balance due in the future



### WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and finish the Comprehensive Problem and complete the practice exercises for your course of study. See the table of contents in Publication 4491-W for additional information.



[illegible]



### Introduction

This lesson will help you address special filing concerns of United States service members. To do this you need to determine where and when to file a federal tax return, who qualifies for an deadline extension, and who qualifies for special tax benefits.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the special tax filing concerns of members of the Armed Forces
- Describe the extensions to file that are available for members of the Armed Forces
- Determine the effect on taxes of being in a combat zone
- Identify the tax forgiveness provisions related to military or terrorist actions

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 3
- ☐ Publication 525
- ☐ Publication 4491-W
- ☐ Form 1040
- ☐ Form 4868
- ☐ Form 8822

### What type of identifying information should members of the Armed Forces place on their tax returns?

Members of the Armed Forces should enter their names, social security numbers, and permanent home addresses on their return. However, taxpayers who are due a refund and do not want it mailed to their permanent home address should enter a current mailing address on the return. A military person living overseas should use an APO or FPO address.

Direct Deposit is a fast, simple, safe, and secure way to receive a refund and is ideal for taxpayers who do not want refunds to be mailed to their permanent home address. Taxpayers enter their bank routing and account numbers in the Refund section of the return. The taxpayer must still provide a permanent home address.



If the postal service does not deliver to the taxpayer's street address and the taxpayer has a post office box, enter the post office box number on the line for the present home address.

### What action should be taken when a member of the Armed Forces moves?

Taxpayers who changed their mailing address during the year should notify the IRS of the change on Form 8822, Change of Address.

Taxpayers who move after filing a tax return should fill out and mail Form 8822 to the IRS service center for the state where their returns were previously filed. The service centers addresses are listed on page 2 of the form.

Form <b>8822</b> <small>(Rev. December 2006)          Department of the Treasury          Internal Revenue Service</small>	<b>Change of Address</b> ▶ Please type or print. ▶ See instructions on back.    ▶ Do not attach this form to your return.	OMB No. 1545-1163
<b>Part I Complete This Part To Change Your Home Mailing Address</b>		
Check <b>all</b> boxes this change affects:		
1 <input type="checkbox"/> Individual income tax returns (Forms 1040, 1040A, 1040EZ, 1040NR, etc.) ▶ If your last return was a joint return and you are now establishing a residence separate from the spouse with whom you filed that return, check here <input type="checkbox"/>		
2 <input type="checkbox"/> Gift, estate, or generation-skipping transfer tax returns (Forms 706, 709, etc.) ▶ For Forms 706 and 709, MA, enter the decedent's name and social security number below		



## EXERCISES

Answers are after the lesson summary.

**Question 1:** Tony, who is due a refund, filed his tax return from his home address in Florida on March 12. On March 30 he was transferred to Puerto Rico. Where should Tony submit his Form 8822, Change of Address?

- A. To the IRS service center for Florida
- B. To the IRS service center for Puerto Rico
- C. Either of the above

## Where and when should members of the Armed Forces file their returns?

### Where should I file the return?

Members of the Armed Forces should send their paper-filed federal returns to the service center for where they currently live.

If the military member is stationed overseas and has an APO or FPO address, file the paper tax return with the IRS Service Center in Austin, Texas, 73301-0215, USA.



Many military facilities have a Volunteer Income Tax Assistance center that will e-file tax returns.

### When should I file the return?

Most individual tax returns cover a calendar year, January through December.

Calendar-year taxpayers who live in the United States or Puerto Rico should file their individual tax returns by **April 15** of the following year.

Taxpayers who have a balance due can pay by check, money order, electronic funds withdrawal, or credit card.



If April 15 falls on a weekend or holiday, then the due date is the next business day.

## What can members of the Armed Forces do if they are unable to pay the tax due?

Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, Installment Agreement Request.

The IRS will try to arrange an installment payment agreement that reflects the taxpayer's ability to pay the tax owed. However, taxpayers should pay as much as possible with their return to reduce the amount of interest and penalties that will be added to the unpaid balance.

Taxpayers can now complete an Online Payment Agreement (OPA) application via the Internet at [www.irs.gov](http://www.irs.gov). This application will allow the taxpayer or an authorized representative (Power of Attorney) to self-qualify, apply for an installment/payment agreement, and receive immediate notification of approval.

Form <b>9465</b> (Rev. December 2008) Department of the Treasury Internal Revenue Service	<b>Installment Agreement Request</b>  ▶ If you are filing this form with your tax return, attach it to the front of the return. Otherwise, see instructions.	OMB No. 1545-0074
<b>Caution:</b> Do not file this form if you are currently making payments on an installment agreement or can pay your balance due in full within 120 days. Instead, call 1-800-829-1040. If you are in bankruptcy or we have accepted your offer-in-compromise, see <b>Bankruptcy or offer-in-compromise</b> on page 2.		
This request is for Form(s) ▶ (for example, Form 1040) and for tax year(s) ▶ (for example, 2007 and 2008).		
1 Your first name and initial	Last name	Your social security number
If a joint return, spouse's first name and initial	Last name	Spouse's social security number



## EXERCISES (continued)

**Question 2:** Taxpayers who attach Form 9465, to their tax return will avoid interest charges on any tax balance they cannot pay by the due date. ☐ True ☐ False

## What are the extension requirements for taxpayers within the U. S.?

Deadline extensions are available to members of the Armed Forces who served in a combat zone. Taxpayers can receive extensions of time to file their returns. Different rules apply to taxpayers who live in the U.S. and those who live outside the U.S.

The IRS will charge interest on taxes not paid by the due date, even if an extension of time to file is granted. The only exception is when the combat zone extension applies.

### TIP

See Publication 3, Armed Forces Tax Guide, for extensions of deadlines and deferrals of taxes due that may apply to members of the Armed Forces.

## How does a taxpayer get an automatic extension?

Taxpayers living in the United States can receive an automatic six-month extension of time to file their federal tax returns.

To get the automatic extension, taxpayers must file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, by the due date for their tax return (usually April 15). Calendar-year taxpayers who take the extension will have until October 15 to file their tax return.

**Form 4868**  
Department of the Treasury  
Internal Revenue Service (99)

**Application for Automatic Extension of Time To File U.S. Individual Income Tax Return**  
For calendar year 2008, or other tax year beginning , 2008, ending , 200

OMB No. 1545-0074  
**2008**

Part I Identification		Part II Individual Income Tax	
1 Your name(s) (see instructions)		4 Estimate of total tax liability for 2008 \$	
Address (see instructions)		5 Total 2008 payments	
City, town, or post office State ZIP code		6 <b>Balance due.</b> Subtract line 5 from line 4 (see instructions)	
2 Your social security number	3 Spouse's social security number	7 Amount you are paying (see instructions)	
For Privacy Act and Paperwork Reduction Act Notice, see page 4.		8 Check here if you are "out of the country" and a U.S. citizen or resident (see instructions)	
		9 Check here if you file Form 1040NR or 1040NR-EZ and did not receive wages as an employee subject to U.S. income tax withholding	

Cat. No. 13141W Form **4868** (2008)

Taxpayers *cannot* use the automatic six-month extension if they:

- Choose to have the IRS figure their tax, or
- Are under a court order to file their returns by the regular due date

## Will the taxpayer owe interest and/or penalties?

Although taxpayers are not required to pay their tax due when submitting Form 4868, they will owe interest on any tax not paid by the original due date. Interest will be charged from the due date to the date of payment.

In addition, taxpayers may be charged a late-payment penalty if the amount of tax paid before the due date (from withheld taxes or estimated tax payments) is less than 90% of the actual tax owed.

If Form 4868 is filed late, the request for an extension will be denied, and the IRS will inform the taxpayer that the request was denied.



For more details on penalties, refer to filing information in Publication 17.



## EXERCISES (continued)

**Question 3:** Which of the following calendar-year taxpayers can receive an automatic six-month extension?

- A. Avery, who filed Form 4868 in February and chose to have the IRS figure his taxes
- B. Benton, who filed Form 4868 on April 15 and did not include any tax payments
- C. Calvin, who filed Form 4868 on April 20 and included a tax payment that was over 90% of what he owed
- D. None of the above

## How does the taxpayer file the return?

When the tax return is actually filed, any payment that was submitted with Form 4868 should be added to the total on:

- Line 10 (total payments), Form 1040EZ
- Line 43 (total payments), Form 1040A

To the left of the line, enter “Form 4868” and show the amount paid in order to receive credit for the payment.

Enter the amount on line 67, Amount paid with request for extension to file, if filing Form 1040.

## What are the extension requirements for taxpayers outside the U.S. and Puerto Rico?

Extension requirements for taxpayers who live in the United States differ from those who live outside the U.S.

### Who qualifies for an Automatic Two-Month Extension?

U.S. citizens and resident aliens are allowed an automatic two-month extension to file their return if they:

- Are living outside the U.S. and Puerto Rico on the due date of the return, and their main place of business or assigned tour of duty is outside the U.S. and Puerto Rico
- Are members of the Armed Forces and assigned to a tour of duty outside of the United States and Puerto Rico for a period that includes the entire due date of the tax return (January 1 - June 15)

Although calendar-year taxpayers in this situation don't have to file until June 15, they will owe interest charged from the April 15 due date to the date the tax is paid.

In this instance, Form 4868 is not required.

#### **TIP**

Traveling outside the United States and Puerto Rico on the due date does not qualify the taxpayer for an automatic two-month extension.

### What must taxpayers attach to their return?

Taxpayers using the automatic two-month extension must attach a statement to their return stating that they meet the requirements.

### What is the extension rule for married taxpayers?

For married taxpayers who file jointly, only one spouse needs to meet the requirements to take advantage of the automatic extension to June 15.

For married taxpayers who file separately, only the spouse who meets the requirements qualifies for the automatic extension. If both spouses meet the requirements, each may take advantage of the extension.

## How can a taxpayer request an additional extension?

Taxpayers who live outside the U.S. and Puerto Rico and whose main place of business or assigned tour of duty is outside the U.S. and Puerto Rico can also request an additional extension by filing Form 4868 by the automatic extension date of June 15 and checking the box on line 8.

The due date will then be extended to **October 15**.



### EXERCISES (continued)

**Question 4:** Which of the following calendar-year taxpayers has until June 15 to file a tax return? (Select all that apply.)

- A. Weston, who files a joint return with his wife, Sheila. She was stationed in the Philippines from January through May, and they paid their taxes by credit card on April 2.
- B. Lilly, who began working for a company in Mexico in January, but whose main home is still in Texas. She filed Form 4868 on April 10.
- C. Dwayne, who was stationed in South Korea from February through July.
- D. None of the above

**Question 5:** Pvt. Franklin, a U.S. citizen, is a calendar-year taxpayer. What would the due date be for him to file a return if his assigned tour is in Puerto Rico?

- A. April 15
- B. June 15
- D. June 16

## What are the tax options for combat zone participants?

For members of the Armed Forces serving in a combat zone or qualified hazardous duty area, the deadline for filing tax returns, paying taxes, filing claims for refunds, and taking other actions with the IRS is automatically extended.

The deadline for taking action with the IRS is extended 180 days after the later of:

- The last day in a combat zone/qualified hazardous duty area
- The last day of any continuous hospitalization for injury from service in a combat zone or qualified hazardous duty area

In addition to the 180 day extension, the deadline is also extended by the number of days that were left to take the action with the IRS when you entered a combat zone (or began performing qualifying service outside the combat zone). If a taxpayer entered the combat zone or qualified hazardous duty area before the period of time to take action began, the deadline is extended by the entire period of the time to take action.



Generally, spouses of individuals who served in a combat zone are entitled to the same deadline extension. There are two exceptions:

- Any tax year beginning more than two years after the date the area ceases to be a combat zone
- Any period the qualifying individual is hospitalized in the U.S. for injuries incurred in a combat zone

In these instances, the extension does not apply to a spouse.

#### example

Captain Kristina Jones entered a combat zone on December 1, 2006. She remained there through March 31, 2008, when she departed for the U.S. She was not injured and did not return to the combat zone. Her deadlines for filing 2006, 2007, and 2008 returns are:

- 2006 tax return deadline is January 10, 2009. This deadline is extended by 285 days (180 plus 105) after the Captain's last day in the combat zone. The 105 additional days are the number of days in the 3½ month filing period that were left when she entered the combat zone (January 1 – April 15, 2007).
- 2007 tax return deadline is January 10, 2009; the deadline is extended by 285 days (180 plus 105).
- 2008 tax return deadline is not extended because the 180-day extension period after March 31, 2008, ends on September 27, 2008 (which is before the start of the next filing period, January 1 – April 15, 2009).

Publication 3, Armed Forces' Tax Guide will provide additional information for combat zone extension of deadlines.



#### EXERCISES (continued)

**Question 6:** If a member of the Armed Forces served in a combat zone from December 30, 2006, through May 31, 2008, and was not injured, the deadline for filing a 2006 tax return would be extended by how many days?



Request Publication 3, Armed Forces Tax Guide if you prepare returns at a military site. There are many special provisions that apply to service personnel and this publication a valuable reference.



## What are other tax options for combat zone participants?

Other situations that count as time served in a combat zone or qualified hazardous duty area are:

- Missing status such as missing in action or prisoner of war time counts as time served
- Support personnel including Red Cross, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces
- Hospitalization outside the U.S. and up to five years of hospitalization in the U.S. as a result of an injury

## When can taxes be deferred?

Reservists called to active duty or regular Armed Forces members not in a combat zone may still qualify to defer the payment of back taxes by:

- Serving their initial period of service (the period of active duty following recall to active duty from an inactive reserve or national guard unit or for regular military, the period following induction or first enlistment), or
- Showing that the ability to pay back taxes has been materially impaired because income has dropped as a result of going into military service

## What are rules for deferment?

Armed Forces members who have a current payment agreement or receive a notice requesting payment must make a written request for deferment. The IRS will review each request and advise the taxpayer in writing of its decision.

## Can other parties assist with a tax return?

If a taxpayer wants a third-party designee to discuss a tax return with the IRS, the “Yes” box in the third party designee area of the return must be checked. Also, the taxpayer must provide the designee’s name, phone number, and any five numbers the designee chooses as a personal identification number. Volunteers may not be named as a “Third Party Designee.”

The image shows a portion of a tax return form, specifically the 'Third Party Designee' section. It includes a header 'You Owe' and a line for 'Estimated tax penalty (see page 61)'. Below this, there is a question: 'Do you want to allow another person to discuss this return with the IRS (see page 61)?'. There are two checkboxes: 'Yes. Complete the following.' and 'No'. The 'No' checkbox is checked. Below the question, there are three fields: 'Designee's name', 'Phone no.', and 'Personal identification number (PIN)'. The 'Designee's name' field is partially filled with 'John'. The 'Phone no.' field is partially filled with '( )'. The 'Personal identification number (PIN)' field is empty. At the bottom, there is a line for the taxpayer's signature and a declaration: 'I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, this return and accompanying schedules and statements are true and correct.'.

A power of attorney Form 2848 may also be used to grant authority to an individual to represent the taxpayer before the IRS and to receive tax information. A copy must be attached to the return.

Use caution when allowing a representative to sign for someone. See Signatures in the Filing Information chapter in Publication 17 for more information.

If it is not possible to obtain a signature for a joint return from a spouse serving in the combat zone, a signed authorization to act on the taxpayer’s behalf can be accepted. The IRS also accepts a written statement explaining that the spouse is serving in the combat zone. The statement must be signed by the spouse who is not serving in the combat zone and attached to the return.

## What are the tax forgiveness provisions for decedents?

Special tax-forgiveness provisions apply to individuals who die:

- While serving in a combat zone or from wounds incurred while serving in a combat zone, or
- From wounds or injuries incurred in a terrorist or military action while working for the U.S. government



Only the decedent's part of the joint income tax liability is eligible for the refund or tax forgiveness.

The combat zone tax forgiveness provision applies for the year of death and for any prior year ending on or after the first day that the individual served in a combat zone. Any forgiven tax liability that has already been paid, will be refunded.

The tax forgiveness provision also applies to those taxpayers serving outside the combat zone if the service:

- Was in direct support of military operations in the zone, and
- Qualified the member for special military pay for duty subject to hostile fire, imminent danger, and/or terrorist actions



### EXERCISES (continued)

**Question 7:** Mr. Tim Morris, a civilian employee of the United States, died in 2008 as a result of injuries he suffered during a terrorist attack in 2006. What years are Mr. Morris' income liabilities forgiven?

- A. 2006 through 2007
- B. 2006 through 2008
- C. 2005 through 2008

## What are the rules for filing a return for decedents?

The personal representative must file the final income tax return for the year of death and any returns not filed for preceding years. A surviving spouse may have to file the returns for the decedent.

To make a claim, the decedent's representative must file:

- Form 1040EZ, Form 1040A, or Form 1040 for each year an income tax return has not yet been filed
- Form 1040X for each year an income tax return has already been filed

If an individual died after the tax year, but before the return for that year was filed, the return for the tax year is not the final return; it is a regular return. The return for the year the taxpayer died will be the final tax return.

### example

Bob died in February 2007. His 2006 tax return – due on April 15, 2007 – is not the final tax return. The final tax return would be the 2007 Form 1040, due April 15, 2008.

The final tax return is due at the same time the decedent's return would have been due had the death not occurred.



**TaxWise Hint:** Type the date of death of the taxpayer or spouse in the appropriate box. If you have not previously done so, go to the Name Line 2 in the U.S. address area at the top of the Main Information sheet and enter the name of the person filing the return for the deceased person. This may be the surviving spouse if the filing status is Married Filing Jointly, or a personal representative such as an executor, administrator, or anyone who is in charge of the deceased taxpayer's property.

For information on signing a joint return if one spouse has died or cannot sign the return, see Publication 17 Index, keyword: Signatures.

## Summary

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This lesson will help you determine special filing concerns for members of the U.S. Armed Forces.

- Like all taxpayers, members of the Armed Forces should send their federal returns to the service center for where they currently live
- Most taxpayers who live in the U.S. or Puerto Rico should file their individual tax returns by April 15
- Taxpayers who changed their mailing address should notify the IRS of the change on Form 8822, Change of Address
- Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, Installment Agreement Request
- The extension rules vary depending on whether the taxpayer lives in the U.S. or outside the U.S.
- For members of the Armed Forces serving in a combat zone or Qualified Hazardous Duty Area, deadlines for taking action with the IRS are automatically extended until 180 days (plus any time remaining to take action) from the time the member leaves the combat zone/qualified hazardous duty area
- The income tax liability of a member of the Armed Forces is forgiven if a member dies as a result of service in a combat zone or from a terrorist or military action outside the U.S.
- The terrorist or military action forgiveness also applies to an individual who is a U.S. employee at death and dies from wounds or injuries incurred in a terrorist or military action regardless of where the action occurred



## WORKBOOK EXERCISE

For additional practice on material covered in this lesson, go to Publication 4491-W and finish the Comprehensive Problem and complete the practice exercises for the Military course. See the table of contents in Publication 4491-W for additional information.



## EXERCISE ANSWERS

**Answer 1:** A. Because he already filed his return from his previous address, Tony should submit Form 8822 to the service center for his previous address.

**Answer 2:** False. Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, Installment Agreement Request. The IRS will try to arrange an installment payment agreement that reflects the taxpayer's ability to pay the tax owed. Maximum payments should be made to limit applicable interest and penalty charges on the unpaid tax.

**Answer 3:** B. To get the extension, taxpayers must file Form 4868 by the return's due date. They don't have to pay their tax when submitting Form 4868, but they will owe interest on any tax not paid by the due date.

**Answer 4:** A & C. For Weston and Sheila, who file jointly, only one spouse needs to meet the requirements to take advantage of the automatic extension. Dwayne's due date is automatically extended to June 15.

**Answer 5:** A. April 15

**Answer 6:** The deadline for filing the 2006 tax return is 180 days plus the number of days remaining for the Armed Forces member to take action after entering the combat zone. The deadline for 2006 is extended 285 days (180 plus 105) after leaving the combat zone, to March 12, 2009. The 105 additional days are the number of days in the 3-1/2 month filing period that were left when the taxpayer entered the combat zone on December 30th (January 1 - April 15, 2007).

**Answer 7:** C. 2005, 2006, 2007, 2008

[illegible]



### Introduction

This lesson will help you determine how to amend a 2008 return that was originally created using TaxWise and can be accessed at your volunteer site.

These are several reasons taxpayers may need to amend a return, for example:

- Additional Forms W-2, Wage and Tax Statement, or Forms 1099-INT, Interest Income, are received after a taxpayer has filed a return at your VITA/TCE site
- Taxpayers realize, after claiming a personal exemption, that they can be claimed as a dependent on another person's tax return

If a taxpayer requests your help in filing an amended return, first ask to see the original return. Examine the return carefully, looking for obvious errors. Then ask the taxpayer to identify and explain the errors. Try to determine if the original return is, in fact, in error.

Ask probing questions, using the interview techniques and tools discussed in the Screening and Interviewing lesson. See the Volunteer Resource Guide (Tab 14) for the TaxWise screens referenced in this lesson.



**TaxWise Hint:** You can prepare an amended return using TaxWise. However, an amended return cannot be filed electronically; it must be mailed to the IRS.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify when it is appropriate to prepare an amended return, Form 1040X, Amended U.S. Individual Income Tax Return
- Determine the time limits for filing Form 1040X
- Identify how to assemble and submit Form 1040X

#### What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Volunteer Resource Guide
- ☐ Form 1040X
- ☐ Form 1040X Instructions

#### **Optional:**

- ☐ Form 1040 Instructions
- ☐ Form 8379

## When is an amended return required?

Taxpayers should file amended returns to correct any errors on a return they have already filed. Amended returns use Form 1040X.

An amended return is not always required when the original return has an error. For example, the IRS will usually correct a math error on a return, or they will write the taxpayer and request a missing schedule or form. In these cases, do not amend the return. If the taxpayer receives a notice from the Internal Revenue Service, refer the taxpayer to the contact person and telephone number on the notice.

File an amended return if taxpayers:

- Received another Form W-2, a corrected Form W-2, or another income statement (such as unemployment compensation) that was not reported on the original return, or
- Received an additional Form 1099 or a corrected Form 1099 that was not reported on the original return, or
- Claimed their own personal exemption on the return when someone else was entitled to claim them, or
- Claimed deductions or credits they should not have claimed, or
- Did not claim deductions or credits they could have claimed, or
- Should have used a different filing status

### example

Two weeks after Bernard's 2008 tax return was filed, he received another Form W-2 in the mail. The volunteer tax preparer reviews Bernard's file to be sure the Form W-2 wasn't included on the original 2008 return. The volunteer then helps Bernard prepare Form 1040X to include the additional Form W-2 on the 2008 return.

## Is an amended return needed for injured spouse situations?

When a joint return is filed and only one spouse owes a past due amount such as child support, an education loan, or prior year's taxes, the other spouse can be considered an injured spouse. The injured spouse should file Form 8379, not Form 1040X. See Publication 17, Form 8379, and Form 1040X instructions for further information.



If the federal return has to be amended, often the state return must also be amended.



After the due date of the original return, a taxpayer can change from Married Filing Separately to Married Filing Jointly, but cannot change from Married Filing Jointly to Married Filing Separately. However, an executor may be able to make this change for a deceased spouse. Refer to Publication 17 for more information.

## How do I start?

To file an amended return, you need the taxpayer's copy of the original return and the information that needs to be changed.

- Begin by researching and verifying that the change requested by the taxpayer is correct. Review the approved intake and interview sheet with the taxpayer **and** use the Volunteer Resource Guide and Publication 17 to make sure that what the taxpayer wants to change is correct.
- Get all the facts before preparing Form 1040X. Ask the taxpayer if they have received any correspondence from the IRS making changes to the original return, or if the taxpayer has amended the return for another issue. You will need this information to properly amend the return. For example, the parents of a college student correctly claimed their child as a dependent. However, their child also filed a return and incorrectly claimed the personal exemption. The child's return was processed first. In this situation, the IRS would adjust the parents' return by removing the exemption for the child. You will need this information to correctly amend the parents' and child's returns.

Before we get started in TaxWise, let's look at the format of a Form 1040X Amended U.S. Individual Income Tax Return.

## What is Form 1040X?

Form 1040X is not year specific. You must specify the year for which the amended return is being prepared. When preparing a paper Form 1040X, be sure you are using the latest version of the form. The revision date is in the upper left corner. As of June 2008, the latest revision is November 2008.

The image shows the top portion of Form 1040X. The header includes the form number 'Form 1040X' with '(Rev. November 2008)' below it, the title 'Amended U.S. Individual Income Tax Return', and the OMB No. 1545-0074. Below the title is the instruction 'See separate instructions.' The main body of the form is a table with a vertical label on the left that reads 'Please print or type'. The table has four rows. The first row is for the taxpayer's information, with columns for 'Your first name and initial', 'Last name', and 'Your social security number'. The second row is for a joint return, with columns for 'If a joint return, spouse's first name and initial', 'Last name', and 'Spouse's social security number'. The third row is for contact information, with columns for 'Home address (no. and street) or P.O. box if mail is not delivered to your home', 'Apt. no.', and 'Phone number'. The fourth row is for location information, with a single column for 'City, town or post office, state, and ZIP code. If you have a foreign address, see page 3 of the instructions.'

The sentence under the Form 1040X header says, "This return is for calendar year \_\_\_\_\_, or fiscal year ended \_\_\_\_\_." The taxpayers served by the VITA/TCE program are calendar-year taxpayers. That is, they report income received from January 1 through December 31. They claim allowable deductions paid from January 1 through December 31. If you were preparing a paper return, you would insert the appropriate tax year after "calendar year." If you are using TaxWise and the original return is on the computer, TaxWise will enter the year for you.



Form 1040X has 3 columns:

- Column A is used to show the **original** or **IRS adjusted figures** from the original return or previous amendment
- Column C is used to show the corrected figures
- The differences between the figures in columns A and C are shown in column B

Form 1040X, Part I, Exemptions, (on page 2) is filled out only if you are adding or taking away personal or dependency exemptions.

Form 1040X, Part II, Explanation of Changes, (on page 2) is used to explain specific changes being made on the return and the reasons for each change. Explanations should be easily understood and clearly point out that the taxpayer qualifies for the change. For example, “taxpayer received another W-2 after they filed original return,” or “taxpayer qualifies to claim child care expenses of \$600 for their 10 year old dependent child, Form 2441 attached,” or “taxpayer meets the qualifications to file as Head of Household instead of Married Filing Separately.”

Be sure to take note of the instructions under Part II, Explanation of Changes. It reminds the taxpayer filing Form 1040X to include his or her name and social security number on any attachments filed with the form.



The starting point in column A may be an adjusted figure from the original return if another amended return was previously filed or if the IRS changed something on the original return.

## What are the time limits on amending a return?

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### What is the time limit on refunds?

There is a statute of limitations on refunds being claimed on amended returns. In general, if a refund is expected on an amended return, taxpayers must file the return within three years from the due date of the original return, or within two years after the date they paid the tax, whichever is later.

Returns filed before the due date (without regard to extensions) are considered filed on the due date.

#### example

Robert's 2005 tax return was due April 15, 2006. He filed it on March 20, 2006. He amends the 2005 return, expecting the correction to result in a refund. If he gets it postmarked on or before April 15, 2009, it will be within the three-year limit and the return will be accepted. But if the amended 2005 return is postmarked after April 15, 2009, it will fall outside the three-year period and he will not receive the refund.

Time periods for claiming a refund are suspended for a period when a taxpayer is “financially disabled.” It is, however, very rare that a taxpayer qualifies for that status. You can read the definition of financial disability in Publication 17 in the Filing Information chapter.

There are a few exceptions to the three-year limit rule; for example, a taxpayer may be able to claim a loss on a debt or securities that became worthless in a prior year, an injured spouse claim may be filed for up to seven prior years, and certain Military issues may go beyond the three-year limit. If you think the taxpayer may qualify for an exception to the three-year time limit rule, refer the taxpayer to a professional tax preparer.

### **What if taxpayers are due a refund on their amended return?**

If the amended return indicates that the taxpayer is due a refund, be sure to advise the taxpayer that:

- The taxpayer must wait until the original return is processed (up to 8 weeks after filing the original return).
- The taxpayer can cash the original refund check, if any, while waiting for any additional refund.
- Interest will be paid for a refund on an amended return from the due date of the original return or the date the original return was filed, whichever is later, to the date the amended return is filed. (This interest will be taxable on the tax return for the year in which it is received.)
- Generally, it takes 8-12 weeks to process an amended tax return.



Guidance issued in August 2008 stated that the current processing time for amended returns is 12-16 weeks. Since this may change, check with your Instructor or Site Coordinator for the latest information.

### **What if the taxpayer owes money on the amended return?**

If the amended return indicates that the taxpayer owes money, file Form 1040X and instruct the taxpayer to pay any tax due by the April due date to avoid any interest and penalties.

Even if the taxpayer is filing Form 1040X and cannot pay the balance in full by the April due date, be sure to have them file the return anyway. The IRS will calculate interest on the balance due and send the taxpayer a bill. Interest is calculated based on the amount of tax owed. Interest rates can change every 3 months. The interest is calculated for each day the balance due is not paid in full. Encourage the taxpayer to pay as much as possible to reduce interest and penalties. Refer to Form 1040X Instructions for more information on payment options.



Show the taxpayer the Form 1040X Instructions for how to include all the correct information on the check or money order.



## EXERCISES

Answers are after the lesson summary.

**Question 1:** John e-filed his 2006 Form 1040 on March 31, 2007. The next year, while preparing his 2007 return, John discovered an error in his 2006 return which resulted in a higher refund. John mailed an amended 2006 return on April 19, 2008. Is this too late to qualify for the refund? ☐ Yes ☐ No

**Question 2:** On May 6, 2010, John discovers an error on his timely filed 2006 tax return. Correction of this error would result in a refund. He mails an amended return on May 6, 2010. Is this too late for John to claim a refund? ☐ Yes ☐ No

## How do I complete the amended return in TaxWise?

The scope of preparing amended returns in the VITA/TCE program is limited. Generally you will prepare amended returns in situations where the original return was prepared at that same volunteer site, using TaxWise.

Go to the Volunteer Resource Guide (Tab 14) to review the step-by-step procedures for preparing Form 1040X.

Remember to follow the Interview Process and use the research tools to prepare an accurate return.



The Refund or Amount You Owe section on Form 1040X must be filled out carefully. Look at line 19, "Overpayment, if any, shown on original return." The original refund is entered here. However, if the IRS adjusted the refund, enter that amount instead of the original amount.

## How do I assemble and submit Form 1040X?

### What should be attached?

Remember, Form 1040X can be prepared on TaxWise but cannot be e-filed. Once the amended return is complete, follow these steps to assemble the return for mailing and for the taxpayer's records:

1. From TaxWise, print two copies of the federal amended return and, if there is a state return, two copies of that form: one for the taxpayer's records and one to mail in.
2. Have the taxpayer (and spouse if Married Filing Jointly) sign and date the bottom of the front page of Form 1040X. Check the state return for where to sign and where to mail the state return.
3. Attach all additional or corrected Form(s) W-2 or Form(s) 1099 that the taxpayer received after filing their original return. Be sure you have included any additional Federal income tax withheld.
4. Attach any additional forms or schedules needed to explain the changes.

Explain that normal processing time for an amended return is generally 8-12 weeks. However, at the time this publication went to print, the normal processing time was extended to 12-16 weeks. Also tell the taxpayer that, if they owe money and they are not paying the balance due by the original due date of the return, the IRS will send a bill that will include any interest or penalty amounts. If taxpayers indicate they are unable to pay the total amount due, encourage them to pay as much as possible. Refer to the Form 1040X Instructions for more information on payment options.



**TaxWise Hint:** To view mailing addresses and instructions for Form 1040X while still in the form, place the cursor anywhere on Form 1040X and press the F1 key. The mailing addresses can also be found in Form 1040X instructions.

## Summary

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You can help taxpayers file an amended tax return for the *current year* using TaxWise. In the VITA/TCE program, you can assist taxpayers if they filed the original return at the same volunteer site. Amended returns should be filed if any of the following were reported incorrectly:

- Incorrect filing status
- Incorrect total income
- Incorrect deductions or credits

Remember to use the interview process and research tools to prepare an accurate amended return.

An amended return must be mailed; it cannot be filed electronically.

A refund check on an amended return cannot be direct deposited; a paper check is mailed to the taxpayer.

If you are amending the federal return, you usually have to amend the state return.



### WORKBOOK EXERCISE

For additional practice on material in this lesson, go to Publication 4491-W, Basic supplemental exercise 1 (Madison).



### EXERCISE ANSWERS

**Answer 1:** The answer is “no,” it is not too late. John mailed the amended return before April 15, 2010. That is within the three year period allowed for refunds.

**Answer 2:** The answer is “yes” it is too late. The postmark must be three years from the due date of the return (extended to the next business day). The IRS will disallow John’s amended return requesting a refund because it was filed more than three years after the due date of the original return.

[illegible]

## Appendix A: Vanessa Franklin Taxpayer Scenario

Taxpayer Vanessa Franklin comes to your site and requests assistance with her return. She completed Page 1 and Parts III and IV of Page 2 of an approved intake and interview sheet and presents it to you, along with the following documents listed at the top of the sheet:

- Driver's license
- Letter from social security
- Form W-2, Wage and Tax Statement
- Form 1098-T, Tuition Statement
- Bank routing numbers

Throughout this Appendix A, we will practice what we learn in the Process Based Training Lessons by reviewing Vanessa's documents, interviewing her to clarify issues, and then applying the information to complete her income tax return. See Appendix B for Vanessa's complete return (including her worksheets).

### Lesson 3 Filing Basics

#### Must Vanessa file a return?

To determine if a taxpayer has a filing requirement, you need their age, possible filing status(es), and gross income.

#### Vanessa's Age and Marital Status

Start by reviewing Part I of her approved intake and interview sheet.

#### Part I: Taxpayer Information

1. Your First Name Vanessa		M.I. L.	Last Name Franklin		2. Date of Birth (mm/dd/yyyy) 11/12/1972
3. US Citizen or Resident Alien <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	4. Legally Blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		5. Totally and Permanently Disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		6. Occupation Retail Sales
7. Spouse's First Name Harvey		M.I. M.	Last Name Franklin		8. Date of Birth (mm/dd/yyyy) 07/14/1969
9. US Citizen or Resident Alien <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	10. Legally Blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		11. Totally and Permanently Disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		12. Occupation Cook
13. Address 3344 Cleveland Drive		Apt #	City Denver		State CO
14. Phone Number and e-mail address Phone: ( 303 ) 555-5555 e-mail:		15. Could you or your spouse be claimed as a dependent on the income tax return of any other person? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
16. On December 31 <sup>st</sup> a. Were you: <input type="checkbox"/> Single <input checked="" type="checkbox"/> Legally Married <input type="checkbox"/> Separated <input type="checkbox"/> Divorced <input type="checkbox"/> Widowed b. If married, did you live with your spouse during any part of the last six months of the year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No c. Is your spouse deceased? If yes, provide the date of death. _____ (mm/dd/yyyy)					

#### Part II. Family and Dependent Information – Do not include you or your spouse

### Vanessa's possible filing statuses

On her approved intake and interview sheet, Vanessa indicated that she is married, but has not lived with her spouse during any part of the last six months.

### Vanessa's Family and Dependent Information

To determine Vanessa's possible filing statuses, you need to also look at her family and dependent information. She has indicated three potential dependents in Part II of her approved intake and interview sheet.

#### Part II. Family and Dependent Information—Do not include you or your spouse.

Print the name of everyone who lived in your home and outside your home that you supported during the year.

Name (first, last)  (a)	Date of Birth mm/dd/yyyy  (b)	Relationship to you (son, daughter, etc.)  (c)	Number of months person lived with you last year  (d)	US Citizen, Resident of US, Canada or Mexico (yes or no)  (e)	Is the dependent a full time student? (yes or no)  (f)
Zachary Franklin	09/07/1999	son	12	Yes	Yes
Zoe Franklin	12/15/2003	daughter	12	Yes	No
Annabelle Johnson	11/15/1936	mother	12	Yes	No

You decide to ask some questions to confirm and clarify her information.

### Sample interview clarifying dependents

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*I've reviewed your intake sheet and, to start off with, I want to make sure that you need to file a return based on your filing status, age, and income. So let me verify a few things. You were born on November 12, 1972, correct?*

*Okay, that makes you 36. I see that you checked "Legally Married" but answered "No" to living with your spouse during the past six months.*

*But you were still married on December 31st of last year, correct?*

*Do you and your husband plan to file jointly?*

*And you have two children you may be claiming as dependents, and possibly your mother as a third dependent?*

*Based on this initial information, there are three filing statuses you may qualify for: Married Filing Separately, Head of Household, or Married Filing Jointly, although you expressed that you don't want to use the Married Filing Jointly status.*

##### VANESSA RESPONDS...

Yes.

Yes, Harvey moved out in February 2008.

Yes, that's right.

I think I want to file Married Filing Separately, but I'm not sure.

Yes, that's right.

I'd rather not if I don't have to.



### What are Vanessa's most likely filing statuses?

Vanessa may qualify for Married Filing Separately, Head of Household, or Married Filing Jointly.


### Vanessa's Gross Income

The next step is to make sure her gross income for the tax year is more than the gross income limit in Tab A – Who Must File of the Volunteer Resource Guide.

Remember, at this point, we're determining if Vanessa has a filing requirement so we will do a general review of her income documentation.

### Vanessa's Form W-2

Briefly review Vanessa's Form W-2 and Part III of her approved intake and interview sheet to determine her income for the tax year. Vanessa's W-2 indicates she has income of \$26,000.

a Employee's social security number <b>111-11-5555</b>		Safe, accurate, FAST! Use  Visit the IRS website at <a href="http://www.irs.gov/efile">www.irs.gov/efile</a> .	
b Employer identification number (EIN) <b>39-9999999</b>		1 Wages, tips, other compensation <b>26,000</b>	2 Federal income tax withheld <b>1,240</b>
c Employer's name, address, and ZIP code <b>Bob's Department Store PO Box 456 Denver, CO 80204</b>		3 Social security wages <b>27,000</b>	4 Social security tax withheld <b>1,674</b>
		5 Medicare wages and tips <b>27,000</b>	6 Medicare tax withheld <b>392</b>
		7 Social security tips	8 Allocated tips
d Control number		9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial Last name Suff. <b>Vanessa L. Franklin 3344 Cleveland Drive Denver, CO 80202</b>		11 Nonqualified plans	12a See instructions for box 12 <b>D 1,000</b>
		13 Statutory employee <input type="checkbox"/> Retiree <input checked="" type="checkbox"/> Third party sick pay <input type="checkbox"/>	12b
		14 Other	12c

### Part III. Income – Did you (or your spouse) receive:

- |   |  |  |
|---|--|--|
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 1. Wages or Salary (include W-2s for all jobs worked during the year)  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 2. Tip income  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 3. Interest/Dividends from: checking or savings account, bonds, CDs, or brokerage account                    |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 4. State tax refund (may be taxable if you itemized last year)   |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 5. Self Employment Income - business, farm, hobby, <b>1099-Misc or any earned income not reported on W-2</b> |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 6. Alimony income  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 7. Sale of Stock, Bonds or Real Estate   |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 8. Disability income   |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 9. Pensions, Annuities, and/or IRA distributions   |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 10. Unemployment (1099-G)  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 11. Social Security or Railroad Retirement Benefits (1099-SSA or RRB)  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 12. Other Income: Identify <u>n/a</u>  |



On her approved intake and interview sheet, Vanessa also indicated that she had self-employment income. You next confirm and clarify this and any other income sources. Refer to the Volunteer Resource Guide (Tab D) Income for other income sources you should consider.

**Sample interview probing for other income**

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>Your Form W-2 shows \$26,000 as your wages for the tax year. Tell me about your self-employment income.</i>	I sell cosmetics on the side. I schedule makeup workshops in people's homes in the evenings and on weekends.
<i>How much did you earn doing that?</i>	Not much at all, after I paid my expenses, it was about \$2,400.
<i>Okay, that is close enough for what we are doing now, but we will have to have the exact amount later. You indicate that you received unemployment compensation.</i>	Actually, my husband was the one on unemployment for a couple of months.
<i>Since you're not going to file a joint return, we won't put any of his income or expenses on your return. Okay, any other sources of income, for example, bonuses at your job, or any interest reported on a Form 1099?</i>	No, just the wages and business income.
<i>Okay, so your gross income is about \$28,400 based on your W-2 and income from your business.</i>	

Make notes on Vanessa's approved intake and interview sheet to capture what she has told you; for example, indicate that the "Yes" on the question about unemployment compensation actually refers to her estranged husband.

**Chart A – Who Must File**

Consult Chart A For Most People, Who Must File in the Volunteer Resource Guide (Tab A). Find Vanessa's likely filing status(es), age, and income on the chart.

We have now determined Vanessa's age, her possible filing statuses, and have reviewed her preliminary income information. Because she is under 65 years old and her gross income on her Form W-2 exceeds the income limits listed for each of her possible filing statuses, we know that Vanessa has a filing requirement.

Since Vanessa is required to file a return, the "Label" section of the return must be completed with name, address, and social security number. If Vanessa is filing by herself, only her information will be included.



**TaxWise Hint:** Since it is necessary to use the primary taxpayer's social security number to start a new return in TaxWise, you will not be able to begin this process until you determine Vanessa's filing status.

## Verify Vanessa's Identity

Before completing the TaxWise Main Information Sheet or the Label section of Vanessa's tax return, make sure you verify her identity. Vanessa presents you with her driver's license and a letter from the Social Security Administration.

### Sample interview to verify identity

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>By the way, thanks for taking the time to complete our intake sheet, Vanessa. To make sure no one is masquerading as you, I hope you won't mind showing me proof of identity and your social security card?</i>	Well, here's my driver's license, but I couldn't find my social security card. I had to go to the Social Security Administration office and all they could give me, for now, was this letter. They haven't issued me a new card yet.
<i>That's fine. The letter from their office is a valid substitute. Now, is all the information on your driver's license current and correct? We want to make sure you receive all your tax benefits and that your return is processed smoothly.</i>	Yeah, I haven't moved since getting that license.
<i>Okay then, let's continue reviewing the intake sheet.</i>	Sounds good.

You have now completed these filing basics:

- Determining if there is a filing requirement
- Verifying the identity of the taxpayer and confirming her social security number



Return to lesson 3.



At this point, you may want to review the social security cards for each individual listed in Part II of the taxpayer's approved intake and interview sheet.

## Lesson 4 Filing Status

### What filing status should Vanessa use?

Taxpayer Vanessa Franklin comes to your site and requests assistance with her return. Her approved intake and interview sheet, Part 1, Taxpayer Information and Part 2, Family/Dependent Information indicate that she is married, but lives apart from her husband. She also has three potential dependents (her two children and her mother). Based on this information, her possible filing statuses are:

- Married Filing Jointly
- Married Filing Separately
- Head of Household

Vanessa does not want to use the Married Filing Jointly status, but if she chooses to file Married Filing Separately, it may result in a higher tax.

To determine if Vanessa qualifies for Head of Household, which may result in a lower tax than Married Filing Separately, you decide to ask some questions based on the Filing Status Interview Tips in the Volunteer Resource Guide (Tab B).

### Sample interview clarifying filing status

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*I'm going to ask you a few questions that will help us determine the best filing status for you. First of all, you were married at the end of the tax year, but did not live with your spouse during the last 6 months. Is this correct?*

*Have you obtained a legal separation?*

*And you don't plan to file a joint return with him.*

*There are other options. For now, let's just assume that you won't file Married Filing Jointly, and I'll ask you a few more questions. I see that you have two children. I see that they lived in your home for the entire tax year, is that correct?*

*Did you pay more than half the cost of keeping up your home last year?*

*Okay... Now, I need to clarify the number of months you and your husband actually lived apart. Your intake sheet indicates that he has not lived with you during the last six months of the year, is this correct?*

*Your children may qualify you for the Head of Household status. In order to qualify, they must be your dependents. It looks like they are, but we will be getting to that in a minute. If you qualify for the Head of Household status, it may result in a lower tax for you than Married Filing Separately.*

##### VANESSA RESPONDS...

That's right. We're still married, but we are separated.

No, I haven't been to a lawyer yet.

Right. I was thinking of filing separately.

Yes, they lived with me.

Well, I paid for everything if that's what you mean. Once in a while, Harvey sent some money, but it wasn't enough to help much.

Yes, he moved out in February and we've been apart ever since.

That sounds good to me!

### ***Vanessa's filing status is Head of Household***

Vanessa qualifies as Head of Household because she is legally married, but lived apart from her husband during the last six months of the tax year. She is “considered unmarried for head of household purposes” and at least one of her children must be her dependent to use this filing status. In Part V of Vanessa’s approved intake and interview sheet, check Head of Household.



**TaxWise Hint:** Now that you have determined Vanessa’s filing status, you can “Start a New Return” in TaxWise. Refer to the Volunteer Resource Guide, Tab 1, for detailed instructions about this process. Complete all the required information up to the Dependents/Nondependents section. Confirm each entry with Vanessa and make any corrections on Vanessa’s approved intake and interview sheet.

In the Filing Status section, check the box for Head of Household. Leave the remaining blocks in this area blank until you have discussed the status of her children.



Return to Lesson 4.

## Lesson 5 Personal Exemptions

### What personal exemptions can Vanessa claim?

Let's determine if Vanessa can claim any personal exemptions. Remember, she is married, but lives apart from her husband. Personal exemptions are allowed for the taxpayer and for the spouse if they meet certain requirements.

First, review the Taxpayer Information on her approved intake and interview sheet to see if Vanessa or her husband can be claimed as a dependent on someone else's tax return.

3344 Cleveland Drive	Denver	80202
14. Phone Number and e-mail address Phone: ( 303 ) 555-5555 e-mail:	15. Could you or your spouse be claimed as a dependent on the income tax return of any other person? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
16. On December 31 <sup>st</sup> a. Were you: <input type="checkbox"/> Single <input checked="" type="checkbox"/> Legally Married <input type="checkbox"/> Separated <input type="checkbox"/> Divorced <input type="checkbox"/> Widowed b. If married, did you live with your spouse during any part of the last six months of the year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No c. Is your spouse deceased? If yes, provide the date of death. _____ (mm/dd/yyyy)		
II. Family Dependent Information – Do not include you or your spouse		

Next, ask questions to determine if Vanessa can claim an exemption for her spouse. To do this, use the Interview Tips for Personal Exemptions in the Volunteer Resource Guide (Tab C).

### Sample interview clarifying personal exemptions

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

Let's see if you can claim an exemption for your spouse. I'm going to ask you a few more questions. First of all, we already know that you were married during part of the tax year. So, does that include December 31st?

You have already indicated that you do not plan to file with your husband.

Did he have income of his own last year?

Well, there's our answer. Because he had income and he is required to file his own return, you cannot claim an exemption for your husband.

##### VANESSA RESPONDS...

Yes, that's right. Even though we don't live together anymore, we're still married.

Right.

Yes, he was employed as a cook for most of the tax year, and collected some unemployment compensation.

Because Vanessa cannot claim her husband as an exemption, you will leave him off her return, leaving the box on Form 1040, **line 6b** unchecked.



**TaxWise Hint:** Based on the filing status, Head of Household, TaxWise automatically enters "1" for "Number of boxes checked on 6a and 6b."



Return to Lesson 5.

## Lesson 6 Dependency Exemptions

### What dependency exemptions can Vanessa claim?

Let's determine what dependency exemptions Vanessa can claim. Dependents can be the taxpayer's children or relatives, so begin by reviewing Part II, Family and Dependent Information, on Vanessa's approved intake and interview sheet. She listed three potential dependents.

**Part II. Family and Dependent Information** — Do not include you or your spouse.

*Print the name of everyone who lived in your home and outside your home that you supported during the year.*

Name (first, last)  (a)	Date of Birth mm/dd/yyyy  (b)	Relationship to you (son, daughter, etc.)  (c)	Number of months person lived with you last year  (d)	US Citizen, Resident of US, Canada or Mexico (yes or no)  (e)	Is the dependent a full time student? (yes or no)  (f)
Zachary Franklin	09/07/1999	son	12	Yes	Yes
Zoe Franklin	12/15/2003	daughter	12	Yes	No
Annabelle Johnson	11/15/1936	mother	12	Yes	No

You see that her children are under 10 years of age and her Mother is 72 years old. All three lived with Vanessa for 12 months during the tax year and are U.S. citizens.

#### Vanessa's children

To determine if her children Zoe and Zachary qualify as dependents on Vanessa's tax return, use the Interview Tips for Dependency Exemption for Qualifying Child in the Volunteer Resource Guide (Tab C).

When using the Interview Tips, you may find it helpful to substitute the child's name for the word "person." Ask interview questions individually for each child; as you gain experience with these questions, you will learn to obtain this information for each child at the same time.

Based on Vanessa's answers to the Interview tips you conclude that both children qualify as her dependents. However, because she and her husband are separated, you need to gather more information.

#### Sample interview clarifying dependency exemptions

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>It looks like you should be able to claim your children as dependents. Is there a court document or an agreement that you have signed to allow their father to claim them?</i>	<i>You've got to be kidding. He better not try to claim them.</i>

The special rules of divorced, separated, or never married parents may apply in this situation. They are listed in Publication 17, in the Personal Exemptions and Dependents chapter.

To help determine if Vanessa's husband (the noncustodial parent) can claim the children as dependents on his tax return, use the Interview Tips for Children of Divorced, Separated or Never Married Parents in the Volunteer Resource Guide (Tab C).

After completing the interview using the interview tip in the Volunteer Resource Guide you determine that Vanessa can claim the dependency exemption for both children on her tax return.

### ***Vanessa's mother***

Now, determine if Vanessa's mother is her qualifying relative for a dependency exemption by using the Interview Tips for Dependency Exemption for Qualifying Relative in the Volunteer Resource Guide (Tab C). This time, substitute Annabelle's name for "the person."

Using the interview tips, you learn that although Vanessa's mother receives nontaxable social security, her taxable income (from a small pension) is less than the exemption amount (\$3,500 for 2008). Therefore, Vanessa's mother meets the Gross Income test (step 5).

To answer step 6 in the Interview Tips, you need to help Vanessa make a list of each valid expense she paid for her mother during the tax year, and compare the total amount with her mother's total income for the year. Publication 17 provides a Worksheet for Determining Support in the section on Exemptions for Dependents.

### ***Sample interview clarifying dependency exemptions for "qualifying relative"***

#### **SAMPLE INTERVIEW**

##### **VOLUNTEER SAYS...**

*Let's see if we can add up the monthly expenses that count as support for your mother and figure out if you covered more than half of them, okay?*

*All right, for each item we'll write down the amount you contributed in one column, and the amount your mother contributed in the other column.*

*Let's start with the fair share rental value of her living in your home...*

##### **VANESSA RESPONDS...**

Yes, I've got a list of the expenses here.

Okay, my pencil's ready.

During the interview, you and Vanessa come up with the numbers listed below.

<b>Annabelle's Monthly Expenses</b>	<b>Provided by Vanessa</b>	<b>Provided by Annabelle</b>
Share of food	\$420	\$0
Clothing	\$0	\$200
Share of rent, utilities	\$680	\$0
Medical, dental	\$0	\$1,200
Education expenses	\$0	\$0
Recreation and transportation	\$800	\$700
Furniture, appliances, automobile	\$0	\$0
<b>Share of support</b>	<b>\$1,900</b>	<b>\$2,100</b>



The numbers show that Vanessa did not cover more than half of her mother's (Annabelle's) monthly expenses. Annabelle did *not* pass all five qualifying relative tests, so Vanessa cannot claim an exemption for her mother. Remember to document that Vanessa did not provide more than 50% of her mother's support in Part V, For Completion by a Certified Volunteer, on her approved intake and interview sheet.

### Volunteer Preparer Determinations

Now, you can complete the dependent questions in Part V, For Completion by a Certified Volunteer, on Vanessa's approved intake and interview sheet. Check off the applicable yes/no response and make annotations as needed.

## Part V. For Completion by a Certified Volunteer

**Volunteer Preparer Instructions:** You must conduct a thorough interview to complete an accurate return. This Intake/Interview Sheet is the start of your conversation with the taxpayer. Use the decision trees in Publication 4012, Volunteer Resource Guide, while discussing the questions on this form. **Remember to ask for all documentation.** Update the Intake/Interview Sheet with any changes identified during your interview. Confirm all information with the taxpayer.

- |   |  |  |
|---|--|--|
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 1. Did any of these dependents file a joint return for this tax year?  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 2. Can anyone else claim any of these dependents on their income tax return?                                 |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 3. Did any dependent on the <u>return</u> provide more than 50% of their own support?                        |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 4. Were any of these dependents permanently and totally disabled last year?                                  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 5. Did the taxpayer provide over half the support for each of these dependents?                              |
| <u>2</u>                                |  | 6. Based on the interview, how many individuals qualify as dependents for this return? <i>not her mother</i> |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 7. Based on the interview, does the taxpayer qualify for EIC?  |

Based on the interview, Vanessa can claim dependency exemptions for her two children, but not for her mother.

Vanessa's husband should not claim the children on his return. If he claims them on his tax return, the IRS will apply the tie-breaker rule outlined in the Exemptions/Dependency section of the Volunteer Resource Guide (Tab C) to determine which taxpayer will be eligible to claim the children.

Based on our interview, the entry in item 3 is "No" and in item 5 is "No" because her mother provided over 50% of her own support.

The entry in item 6 is "2" because both of Vanessa's children are qualifying children.

### Preparing Vanessa's Return

At this point, you can complete the Filing Status and Exemptions sections of Vanessa tax return or enter the information in the Main Information Sheet in TaxWise. You will need valid social security numbers for Vanessa's children.



**TaxWise Hint:** TaxWise will calculate Vanessa's exemption deduction. The completed Exemptions section of Vanessa's Form 1040 is in Appendix B.



Return to lesson 6.



## Lesson 8 Income – Wages, Interest, Etc.; Form 1040, Lines 7-11

### What are Vanessa's sources of income?

Let's determine Vanessa's sources of income by reviewing Part III, Income, of Vanessa's approved intake and interview sheet. Before beginning the interview, review the Volunteer Resources Guide (Tab D) Income for examples of income sources not listed in Part III that may be mentioned during the interview.

Vanessa answered "yes" to income from wages and salary, self-employment, and unemployment compensation. In an earlier part of the interview, you learned that the unemployment compensation was her husband's, not hers.

#### Part III. Income – Did you (or your spouse) receive:

- |   |  |  |
|---|--|--|
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 1. Wages or Salary (include W-2s for all jobs worked during the year)  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 2. Tip income  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 3. Interest/Dividends from: checking or savings account, bonds, CDs, or brokerage account                    |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 4. State tax refund (may be taxable if you itemized last year)   |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 5. Self Employment Income - business, farm, hobby, <b>1099-Misc or any earned income not reported on W-2</b> |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 6. Alimony income  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 7. Sale of Stock, Bonds or Real Estate   |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 8. Disability income   |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 9. Pensions, Annuities, and/or IRA distributions   |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 10. Unemployment (1099-G) <i>Husband unemployment income</i>   |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 11. Social Security or Railroad Retirement Benefits (1099-SSA or RRB)  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 12. Other Income: Identify <u>n/a</u>  |

### Sample interview clarifying wage and interest income

Because the approved intake and interview sheet does not list detailed information about wages and taxable interest, you ask some probing questions to learn more about her wage and interest income.

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*Now that we have determined your filing status and who you can claim as a dependent on your return, let's talk about your income. Did you work in 2008?*

*I see, based on your Form W-2, that's Bob Department Store. Did you work for anyone else last year?*

*Great! I wish I could work for myself! So, Bob's was your only source of wages?*

*Did you have any interest income, such as interest from a checking account, savings account, or certificate of deposit?*

*Interest income is reported on a Form 1099-INT. Did you receive any of those forms?*

##### VANESSA RESPONDS...

Yes, I've been working for the same store for years and I have my own cosmetics business.

Just myself.

Yes.

No, I went with a couple of free checking accounts that don't pay interest, one for personal use and one for my cosmetics business.

No, I'm sure you have everything.

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

VANESSA RESPONDS...

*Did you cash in any U.S. savings bonds?*

No.

*Did you receive a state tax refund in 2008?*

No.

*We've identified your total wages as \$26,000.*

What about my cosmetics business and unemployment?

*We will account for those earnings later.*

The volunteer continued reviewing the entries on Vanessa's approved intake and interview sheet as well as Tables A and B in Tab D of the Volunteer Resource Guide with Vanessa. Her responses during the interview did not change any of her answers.

So far you have learned that Vanessa was employed as a sales associate in a retail department store for the entire tax year. She earned no taxable interest from bank accounts. She stated that she owns a cosmetic business but you will ask her questions about that when you explore her self-employment income.

Remember to enter your findings (\$26,000 in wages) next to item 1 in Part III of Vanessa's approved intake and interview sheet.

### Part III. Income – Did you (or your spouse) receive:

- |   |  |   |                         |
|---|--|---|-------------------------|
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 1. Wages or Salary (include W-2s for all jobs worked during the year)                     | <i>Wages = \$26,000</i> |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 2. Tip income   |                         |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 3. Interest/Dividends from: checking or savings account, bonds, CDs, or brokerage account |                         |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 4. State tax refund (may be taxable if you itemized last year)                            |                         |

See Appendix B to review the entries in the Income section of Vanessa's Form 1040.



**TaxWise Hint:** TaxWise automatically computes the taxpayer's total income based on entries on Form 1040, lines 7-21.



Return to Lesson 8.

## Lesson 9 Income; Form 1040, Line 12

### Can Vanessa file Schedule C-EZ?

In Part III, Income, of Vanessa's approved intake and interview sheet, she answered "yes" to self-employment income. You learned that this came from her cosmetics business.

Familiarize yourself with the requirements for filing a Form 1040, Schedule C-EZ, which are found in Part I of the schedule. Refer to the Volunteer Resource Guide (Tab 2) for a facsimile of the schedule. Also, review the instructions for filing Form 1040, Schedule C-EZ before beginning the interview.

You need to ask additional questions about her business income to determine if she can report it on Schedule C-EZ. If she cannot, you will need to refer her to a professional tax preparer.

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*Let's talk about your income from your personal cosmetics business.*

*You may be able to file Schedule C-EZ. If you can't, then I'll have to refer you to a professional tax preparer. First, during 2008, were your business expenses \$5,000 or less?*

*Okay. And clearly you use the cash method of accounting. Did you carry any inventory during the year?*

*Am I correct that the bank statement shows you did not have a loss on the business in 2008?*

*Did you have any employees?*

*And you aren't taking any kind of depreciation or amortization on equipment or property owned by the business?*

*Do you intend on deducting expenses for using your home as your office?*

*Have you always been the only person involved in this business?*

*Good, then we can prepare Schedule C-EZ for you!*

##### VANESSA RESPONDS...

OK, I have all my stuff right here.

Yes, it's right here. I made a summary of all my income and expenses from my business bank account. This account is purely for my business.

No, the only things I have are the samples for parties and individual consultations. When I get an order, I send it through the supplier and the products go directly to the customer or I deliver them personally.

That's right. I sold \$2,990 last year and my expenses were \$590.

No, I did it all myself.

No, I don't have anything like that!

No, not at all.

Yes.

Great!

### Sample interview on use of Schedule C-EZ

You learned key facts that determined that Vanessa can file Schedule C-EZ. She had self-employment income of \$2,990 and expenses of \$590 from her business. She has met all the requirements for the use of a Schedule C-EZ, which is within the scope of the VITA/TCE program.

Next, you ask probing questions to gather information about business expenses which you will enter on Schedule C-EZ.

SAMPLE INTERVIEW (continued)	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>Do you have any Forms 1099-MISC for income from your cosmetics business?</i>	No, all my clients just write me personal checks or pay in cash. But I keep this business account separate from my personal account – it's a lot easier that way!
<i>Good! Does this year-end summary for your business account list all the deposits and expenses for your business?</i>	Yes, it does.
<i>This makes it easy. We will enter this information into TaxWise and it will calculate your net business income or loss. By the way, do you use your vehicle to conduct your business?</i>	Yes, for parties and deliveries, that sort of thing.
<i>Did you keep track of the mileage that went only for your business?</i>	No.
<i>Well, that is a deductible expense. If you do drive anywhere for the business, try keeping a pad of paper in the car and always record your odometer reading, and document the business purpose of the trip.</i>	I sure will!

Before you continue the interview, be sure to indicate Vanessa's responses to these questions on page 2 of the approved intake and interview sheet. In the margins of Part III, item 5, enter "Total income \$2,990, expenses \$590."

**Part III. Income – Did you (or your spouse) receive:**

<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	1. Wages or Salary (include W-2s for all jobs worked during the year)	<i>Wages = \$26,000</i>
<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	2. Tip income	
<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	3. Interest/Dividends from: checking or savings account, bonds, CDs, or brokerage account	
<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	4. State tax refund (may be taxable if you itemized last year)	
<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	5. Self Employment Income - business, farm, hobby, 1099-Misc or any earned income not reported on W-2	<i>Total income \$2,990, expenses \$590</i>
<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	6. Alimony income	

Vanessa's completed Schedule C-EZ is shown in Appendix B. Also see Appendix B, Form 1040, Income section, for her income entries.



**TaxWise Hint:** TaxWise completes Schedule C-EZ and Form 1040 based on your entries on the Net Profit from Business section.



Return to Lesson 9.

## Lesson 13 Income – Unemployment Compensation; Form 1040, Line 19

### What “other income” must Vanessa report?

Recall that taxpayer Vanessa Franklin is married, but lives apart from her husband. You have already identified her income from wages and from self-employment. On her approved intake and interview sheet she checked “Yes” for unemployment compensation, but in an earlier part of the interview she indicated that her husband had received that income.

Vanessa may have received other income that must be reported. A list of possible sources of other income is found in the Income section of the Volunteer Resource Guide (Tab D).

Based on the approved intake and interview sheet, you ask additional probing questions to validate her unemployment entry.

### Sample interview clarifying other income

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*I recall that your husband received unemployment compensation during the tax year, but that the two of you were living apart. Is that correct?*

*As I may have mentioned before, because you are filing as Head of Household, instead of a joint return, you won't need to report any of his income. He'll do that on his own return.*

*No, you don't need to report child support payments.*

*Did you receive any other income in 2008? Here is a list of things that are considered income. Did you receive any of these in 2008?* [Volunteer shows Vanessa Table A, Examples of Income, in the Volunteer Resource Guide, Tab D.]

*Okay, that finishes up the Income section. If you'll look at the screen, this is your total income. Next, we'll discuss any adjustments to your income.*

##### VANESSA RESPONDS...

Yes, that's right.

Well, I should tell you that my husband has sent me a couple of checks to take care of the kids. Should we declare that?

I'm glad to know that!

I don't think so. No, I'm sure I didn't.

After such an interview, be sure to record any additional information you gained from the taxpayer's responses on page 2 of the approved intake and interview sheet.

### Completing the return

Enter Vanessa's income from wages on Form 1040, line 7; enter her business income (from Schedule C-EZ) on line 12. Vanessa does not have any other income entries.



Return to Lesson 13.

## Lesson 17 Adjustments to Income

### Can Vanessa claim any adjustments to her income?

“Adjustments to income” are amounts that Vanessa can subtract from her total income. Before interviewing Vanessa about possible adjustments to her income, review the Adjusted Gross Income section of her tax return; Publication 17, Adjustments to Income section; and the Adjustments section of the Volunteer Resource Guide (Tab E).

Also, review Vanessa’s approved intake and interview sheet, particularly items 3 and 5 in Part III (Income), and items 1, 2, and 3 in Part IV (Expenses).

In Part III Vanessa indicates that she had self-employment income. She can deduct one-half of her self-employment tax as an adjustment to her income. (This adjustment is calculated on Form 1040 Schedule SE; this will be covered in Lesson 28, Other Taxes.)



**TaxWise Hint:** TaxWise automatically calculates the adjustment to income for the applicable self-employment income.

Because the approved intake and interview sheet does not list all the possible opportunities for adjustments to her income, you may find it helpful to ask Vanessa about each entry in the Adjusted Gross Income section of Form 1040. At a minimum, you must validate the responses she gave on her approved intake and interview sheet.

During the interview, Vanessa indicates that she neither paid nor received alimony. You ask her probing questions about possible IRA contributions.

### Sample interview about IRA contributions

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>I see from box 12 of your W-2 that you put \$1,000 into your 401k account. Did you make any contributions to an IRA or any other retirement account?</i>	<i>Yes, I put \$600 into my IRA.</i>
<i>Okay. When did you make the contribution and what type of IRA was it, traditional or Roth?</i>	<i>It's a traditional IRA. I did it last May, I think. Yes, here's the statement. I always try to put part of my tax refund into my IRA.</i>
<i>Great. It looks like your income is within the limits, so you can deduct the entire IRA contribution.</i>	<i>Thanks!</i>
<i>Did you ever make IRA contributions that you didn't deduct?</i>	<i>No, I just have this one account, and I've always taken the deduction.</i>
<i>Okay. Now, until April 15, you can still make deductible contributions up to a total of \$5,000 and deduct them for this tax year. Are you planning on contributing any more to your IRA account?</i>	<i>I'll save part of my refund again, but I want to put that toward next year's deduction.</i>
<i>Sounds like you've thought about it and have a plan.</i>	<i>Yes, I have.</i>





[Return to Lesson 17.](#)

## Notes

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.



## Lesson 19 Standard Deduction and Tax Computation

### How does the standard deduction affect Vanessa's tax liability?

As you recall, Vanessa qualifies to file as Head of Household and was employed as a sales associate in a retail department store for the entire tax year. She was also self-employed with her own cosmetics business.

Let's determine if it would be more beneficial for Vanessa to itemize or to take the standard deduction. The deductions section of the Volunteer Resource Guide (Tab F) contains helpful charts and interview tips for completing this section of the tax return.

#### Sample interview exploring standard deduction

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>Based on your filing status as Head of Household, your standard deduction is \$8,000.</i>	Should I itemize this year?
<i>Your intake sheet indicates that you did not have any home mortgage payments such as interest or taxes.</i>	That's right.
<i>Did you and your dependents have any expenses in 2008 for things like medical or dental treatments, or for losses from casualty or theft?</i>	Well, I did have some medical and dental expenses, but it wasn't anything unusual.
<i>Did you make any charitable contributions?</i>	I made some donations. I have the receipts in this envelope.
<i>Well, based on the fact that you had some medical expenses and some donations, I think we should try itemizing deductions to see if that gives you a higher deduction. No matter how we handle deductions, we still have tax credits to work out and those may reduce your tax.</i>	I hope you're right!
<i>We'll do our best!</i>	

Vanessa's standard deduction is \$8,000. If her itemized deductions exceed this amount, it is more advantageous for her to itemize her deductions on Form 1040, Schedule A. See the Tax and Credits section of Vanessa's Form 1040 in Appendix B for the proper location of the standard deduction entry.



**TaxWise Hint:** Without itemizing, if you return to TaxWise Form 1040, you see that Line 40 shows the standard deduction for Head of Household (\$8,000) and Line 41 shows Vanessa's AGI reduced by her standard deduction.



Return to Lesson 19.

## Lesson 20 Itemized Deductions

### What deductions can Vanessa itemize?

Let's determine the itemized deductions that Vanessa can claim. Vanessa incurred expenses that may increase her deductions. She currently qualifies for the standard deduction of \$8,000 for the tax year.

Vanessa stated she paid medical and/or dental expenses and donations, so you decided to probe further using the Volunteer Resource Guide (Tab F) – Itemized Deductions Interview Tips.



**TaxWise Hint:** You may enter Vanessa's responses in TaxWise Schedule A as you conduct the interview.

### Sample interview clarifying medical deductions

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*Let's enter all qualified medical deductions for you and your dependents. How much did you pay in health care premiums?*

*Yes, health insurance premiums are deductible as long as they aren't pretax. For this year, we'll enter each of your medical and dental expenses separately. The total comes to \$585 so far. Now let's see if we can deduct some transportation costs. Can you determine how far you drove for your medical and dental care?*

*Well, the reimbursement rate for qualified medical travel for the months you traveled in 2008 was 19 cents per mile. The rate increased to 27 cents per mile during the months of July through December. When I enter your mileage here, it comes to \$19. That brings your medical expenses total to \$604.*

*Not necessarily. Because your medical expenses were less than 7.5% of your adjusted gross income, you don't get the deduction. At this point you would need to have over \$2,072 in order to deduct anything. Thankfully you didn't have those kinds of expenses. But I've entered everything to be sure that I do an accurate return, and it's in there in case something changes your adjusted gross income later.*

##### VANESSA RESPONDS...

Well, I didn't have any health insurance last year, so I had to pay for all our check-ups and my kids' allergy medication prescriptions and dental fillings. If I get health insurance this year, will my payments be deductible on my next tax return?

All my dental and medical appointments were in the same center. Each round trip was 20 miles, and I have receipts for the five trips I took during the months of March and April for a total of 100 miles.

Will all that be deducted from my taxable income?

## Vanessa's Tax Deductions

During the tax year, Vanessa had some state income tax withheld as shown on her Form W-2.

f Employee's address and ZIP code					
15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax
CO	39-9999999	\$26,000	\$257		
					20 Locality name

**Form W-2 Wage and Tax Statement** **2008** Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.  
This information is being furnished to the Internal Revenue Service.

### Sample interview clarifying state and local income tax deductions

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
People can itemize the state and local income tax. Your Form W-2 shows you had some state income tax withheld, so that amount will go on Schedule A. Did you pay any other state or local income tax?	No, just what they take from my paycheck.

### Sample interview clarifying interest deductions

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
Did you pay any interest?	Just the interest on my credit card and my car payments. Is that deductible?
I'm sorry, but it isn't.	

## Vanessa's Gifts to Charity Deductions

During the tax year, Vanessa gave a total of \$200 in contributions to her church. She gives you a copy of the letter she received from her church. She can itemize this deduction.



**TaxWise Hint:** Because \$200 is less than 20% of Vanessa's AGI of \$27,630, you don't need to be concerned about indicating whether the contributions are limited. Simply enter the cash and noncash donations separately under "50% Limit Organizations."

<input type="checkbox"/> Yes <input type="checkbox"/> No	3. Educational expenses for you, your spouse and/or dependents
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	4. Un-reimbursed medical expenses <b>\$604</b>
<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	5. Home mortgage payments (interest and taxes – see Form 1098)
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	6. Charitable contributions <b>\$200</b>
<input type="checkbox"/> Yes <input type="checkbox"/> No	7. Dependent care expenses that allow you (and your spouse – if married) to work

## Vanessa's Miscellaneous Expense Deductions

You read the balance of the Schedule A entries to Vanessa from the form or TaxWise. She stated she paid her bank \$35 for her safe deposit box. The box was used to store her investment documents which makes this a deductible expense.

Since the \$35 she paid is less than 2% of her AGI of \$27,630 she doesn't get the deduction for miscellaneous expenses.

## Itemized Deductions Summary

Vanessa's Form 1040, Schedule A (next page) depicts her total itemized deductions. During the tax year, Vanessa paid medical and dental expenses, state income taxes, and a fee for her safe deposit box. She also contributed money to her church. The total of all her itemized deductions shown on Schedule A is \$457, which is less than her standard deduction amount of \$8,000. Vanessa will take the standard deduction.



**TaxWise Hint:** On Vanessa's Form 1040, you see that:

Line 40 shows the standard deduction for Head of Household (\$8,000) because that amount is greater than the total of Vanessa's itemized deductions (\$457)

Line 41 shows Vanessa's AGI reduced by her standard deduction

Line 42 shows the deduction that Vanessa gets for all her exemptions (3 x \$3,500)

**SCHEDULES A&B**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Schedule A—Itemized Deductions**

(Schedule B is on back)

OMB No. 1545-0074

**2008**

Attachment  
Sequence No. **07**

Name(s) shown on Form 1040

**Vanessa Franklin**

Your social security number

**111 11 5555**

<b>Medical and Dental Expenses</b>	<b>Caution.</b> Do not include expenses reimbursed or paid by others.			
1	Medical and dental expenses (see page A-1)	1	604	00
2	Enter amount from Form 1040, line 38	2	27630	00
3	Multiply line 2 by 7.5% (.075)	3	2072	00
4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4		0 00
<b>Taxes You Paid</b>	5	State and local income taxes	5	257 00
(See page A-2.)	6	Real estate taxes (see page A-5)	6	
	7	Personal property taxes	7	
	8	Other taxes. List type and amount	8	
	9	Add lines 5 through 8	9	257 00
<b>Interest You Paid</b>	10	Home mortgage interest and points reported to you on Form 1098	10	
(See page A-5.)	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-6 and show that person's name, identifying no., and address	11	
<b>Note.</b> Personal interest is not deductible.	12	Points not reported to you on Form 1098. See page A-6 for special rules	12	
	13	Qualified mortgage insurance premiums (See page A-7)	13	
	14	Investment interest. Attach Form 4952 if required. (See page A-7.)	14	
	15	Add lines 10 through 14	15	0 00
<b>Gifts to Charity</b>	16	Gifts by cash or check. If you made any gift of \$250 or more, see page A-8	16	200 00
If you made a gift and got a benefit for it, see page A-8.	17	Other than by cash or check. If any gift of \$250 or more, see page A-8. You <b>must</b> attach Form 8283 if over \$500	17	
	18	Carryover from prior year	18	
	19	Add lines 16 through 18	19	200 00
<b>Casualty and Theft Losses</b>	20	Casualty or theft loss(es). Attach Form 4684. (See page A-9.)	20	0 00
<b>Job Expenses and Certain Miscellaneous Deductions</b>	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-9.)	21	
(See page A-9.)	22	Tax preparation fees	22	
	23	Other expenses—investment, safe deposit box, etc. List type and amount <b>Safe Deposit Box</b>	23	35 00
	24	Add lines 21 through 23	24	35 00
	25	Enter amount from Form 1040, line 38	25	27,630 00
	26	Multiply line 25 by 2% (.02)	26	553 00
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-	27	0 00
<b>Other Miscellaneous Deductions</b>	28	Other—from list on page A-10. List type and amount	28	0 00
<b>Total Itemized Deductions</b>	29	Is Form 1040, line 38, over \$159,950 (over \$79,975 if married filing separately)? <input checked="" type="checkbox"/> <b>No.</b> Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40. <input type="checkbox"/> <b>Yes.</b> Your deduction may be limited. See page A-10 for the amount to enter.	29	457 00
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here	30	

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11330X

Schedule A (Form 1040) 2008

**FOR ILLUSTRATION PURPOSES ONLY**



Return to Lesson 20.



## Lesson 23 Credit for Child and Dependent Care

### Does Vanessa qualify for the Child and Dependent Care credit?

Zoe and Zachary are Vanessa's two dependent children. Let's determine if Vanessa is eligible for the Child and Dependent Care Credit by using the Can You Claim the Credit for Child and Dependent Care Expenses decision tree in Tab G in the Volunteer Resource Guide.

#### Sample interview clarifying Child and Dependent Care credit

#### SAMPLE INTERVIEW

VOLUNTEER SAYS...

VANESSA RESPONDS...

*Did you pay for child care during the tax year?*

Zach attends a free after-school program. My mom watches Zoe most of the time, but she goes to a preschool one day a week.

*You may be able to take the credit for child and dependent care expenses. Let me go over a couple of things with you. I already know that your two dependent children are under 13 so they qualify.*

Okay.

*And I know that you have earned income because you work full time as a Sales Associate in a department store. Did you pay for child care so that you could go to this job?*

Yes.

*And Zoe's day care provider is not a relative, correct?*

The preschool is not. I don't have to pay my mom.

*We already know that you are filing as Head of Household, and meet the conditions of "unmarried" for tax purposes. Did you bring the name, address, and tax identification number of the provider with you?*

Yes, I did.

*What were your child care expenses for the year?*

Well, I pay the preschool \$125 a month, so that would be... \$1,500 for the year.

*Does your company provide any dependent care benefits?*

No.

*Well, your expenses definitely qualify. Now all we have to do is figure out the amount of your Child and Dependent Care credit!*

Great! Thanks for your help!

#### Part IV. Expenses – Did you (or your spouse) make or have:

- |   |  |  |
|---|--|--|
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 1. Alimony payments (if yes, you must provide the name and SSN of the recipient)                     |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 2. Contributions to IRA or other retirement account  |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 3. Educational expenses for you, your spouse and/or dependents                                       |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 4. Un-reimbursed medical expenses <b>\$604</b>   |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 5. Home mortgage payments (interest and taxes – see Form 1098)                                       |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 6. Charitable contributions <b>\$200</b>   |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 7. Child/dependent care expenses that allow you (and your spouse - if married) to work <b>\$1500</b> |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 8. Any estimated tax payments for this tax year  |
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 9. Was EIC previously disallowed? (if yes, you may not be eligible for EIC)                          |

## Computing the child and dependent care credit

Vanessa qualifies for the child and dependent care credit. Use the blank Form 2441 shown below to calculate the amount of the credit. Vanessa paid Koala Bears Day Care (EIN 82-111111) \$1,500 for the tax year. Koala Bears is located at 456 Chapman Avenue in Denver, Co 80202.

Form	2441	<b>Child and Dependent Care Expenses</b> ▶ Attach to Form 1040 or Form 1040NR. ▶ See separate instructions.	OMB No. 1545-0074 <div style="font-size: 24pt; font-weight: bold;">2008</div> Attachment Sequence No. 21
Department of the Treasury Internal Revenue Service (99)		Name(s) shown on return	
		Your social security number	

**Part I Persons or Organizations Who Provided the Care—You must complete this part.**  
(If you have more than two care providers, see the instructions.)

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)

Did you receive dependent care benefits?

No → Complete only Part II below.  
 Yes → Complete Part III on the back next.

**Caution.** If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 61, or Form 1040NR, line 56.

**Part II Credit for Child and Dependent Care Expenses**

**2** Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2008 for the person listed in column (a)
First	Last		

**3** Add the amounts in column (c) of line 2. **Do not** enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 35

**4** Enter your **earned income**. See instructions

**5** If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4

**6** Enter the **smallest** of line 3, 4, or 5

**7** Enter the amount from Form 1040, line 38, or Form 1040NR, line 36

**8** Enter on line 8 the decimal amount shown below that applies to the amount on line 7

If line 7 is:			If line 7 is:		
Over	But not over	Decimal amount is	Over	But not over	Decimal amount is
\$0—15,000		.35	\$29,000—31,000		.27
15,000—17,000		.34	31,000—33,000		.26
17,000—19,000		.33	33,000—35,000		.25
19,000—21,000		.32	35,000—37,000		.24
21,000—23,000		.31	37,000—39,000		.23
23,000—25,000		.30	39,000—41,000		.22
25,000—27,000		.29	41,000—43,000		.21
27,000—29,000		.28	43,000—No limit		.20

**9** Multiply line 6 by the decimal amount on line 8. If you paid 2007 expenses in 2008, see the instructions

**10** Enter the amount from Form 1040, line 44, or Form 1040NR, line 41

**11** Enter the amount from Form 6251, line 31

**12** Subtract line 11 from line 10. If zero or less, **stop**. You cannot take the credit

**13** **Credit for child and dependent care expenses.** Enter the **smaller** of line 9 or line 12 here and on Form 1040, line 47, or Form 1040NR, line 44

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Vanessa's employer did not provide any dependent care benefits for her child. Therefore, you do not have to complete Part III of Form 2441 for Vanessa. Vanessa brought the daycare provider's information.

Based on Vanessa's Adjusted Gross Income, her maximum credit is computed at 28% (.28) of her allowable expenses, so her credit can be as high as \$420. This amount is compared to Vanessa's tax. Since her tax is greater than the Child and Dependent Care Credit in this scenario, TaxWise has calculated Vanessa's child and dependent care credit as \$420. This amount is entered into line 47 of Form 1040. Vanessa's completed Form 2441 is in Appendix B.



**TaxWise Hint:** If you entered the child(s) name and social security number correctly on the Main Information Sheet, and you checked the DC (dependent care) box, this information will appear automatically on lines 2a and 2b of Form 2441.

Enter the qualifying expenses for Zoe on line 2c, then TaxWise totals the line 2 amounts. Be careful not to include employer-provided dependent care benefits; if applicable, these are calculated in Part III of this form.

Once you have entered information into lines 1 and 2c, the lines in Part II automatically populate based on amounts already entered into Form 1040, with the exception of the additional information below line 8.

If the taxpayer paid dependent care expenses during this tax year that were incurred during the previous year, enter these expenses, along with the qualifying child's name and social security number in the section below Line 8 of Form 2441.



Return to Lesson 23.

## Lesson 24 Education Credits

### Does Vanessa qualify for any of the education credits?

Vanessa may be able to reduce the amount of tax due if she has education expenses that qualify for the Hope or Lifetime Learning Education Credits.

#### Sample interview clarifying education credits

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>Let's talk about your education-related expenses. Were you, or was anyone else in your family, going to school?</i>	I took one class in the fall.
<i>You're filing as Head of Household. Do you have a receipt for the tuition?</i>	Yes, these are the receipts from City College.
<i>OK. \$450 for tuition and \$80 for books. Were you required to purchase the books through City College or could you have bought them elsewhere?</i>	These books were written specifically for the course and had to be purchased through the school when I registered.
<i>In that case, we can include the books. That totals \$530. I have a few more questions I need to ask. Did you receive any funds from an educational assistance program provided by your employer?</i>	Yes, the EAP paid \$100.
<i>Did you make any tax-free withdrawals from a Coverdell educational savings account or another qualified tuition program, or from U.S. savings bonds?</i>	No.
<i>Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, that were specifically for educational expenses?</i>	Well, my mom gave me \$100 to help with tuition.
<i>The \$100 was a gift so we don't include it. Your total payments were \$530. We must subtract the \$100 employer benefit. That let you use \$430 for lifetime learning credits. Do you have any questions about all this?</i>	No, I'm really glad I can use the expense on my return.

Vanessa qualifies for the lifetime learning credit because she is not a full-time student. Make a note on Part IV of Vanessa's approved intake and interview sheet that she has qualified educational expenses.

### Computing the education credit

Both the Hope credit and the lifetime learning credit are calculated on Form 8863. Vanessa's completed form is shown in Appendix B.



**TaxWise Hint:** On Form 8863, enter Vanessa's name and social security number in Part II and \$430 in 3(c). TaxWise will calculate the tentative credit and allowable lifetime learning credit. The credit is then entered on the education credit line on Form 1040.



Return to Lesson 24.

## Lesson 26 Child Tax Credit

### Is Vanessa eligible for the full child tax credit?

Vanessa's responses in the Family and Dependent Information of the approved intake and interview sheet indicate that her children may qualify for the child tax credit. If she qualifies, the credit reduces her tax liability by up to \$1,000 for each qualifying child.

Using the Child Tax Credit and Additional Child Tax Credit Interview Tips in the Credits section of the Volunteer Resource Guide (Tab G), you can conclude that both children:

- Are under the age of 17
- Are children of Vanessa
- Are U.S. citizens
- Lived in her home for more than 6 months

You also conclude that you must use the Child Tax Credit Worksheet from Publication 972 to calculate Vanessa's credit.

She made contributions to a retirement savings account and may be eligible to complete Form 8880 for another credit.

### Sample interview clarifying the child tax credit

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*You probably qualify for the child tax credit, but let me ask you a few questions just to be sure.*

*Let's see, both Zachary and Zoe are under age 17, correct?*

*And we know that they are both U.S. citizens.*

*They lived with you for the entire year?*

*And we've already established they did not provide any of their own support.*

*Well, since you are claiming both of your children as dependents and they meet the status of a qualifying child for the child tax credit, you qualify for this credit.*

##### VANESSA RESPONDS...

Okay.

Yes.

That's correct.

Yes

No, of course not, they're just little kids!

### Computing the Child Tax Credit

Vanessa qualifies for the Child Tax Credit. Her credit is calculated as shown on the Child Tax Worksheet (from Publication 972) in Appendix B.

Vanessa's tax liability on line 46 of Form 1040 is \$913. Remember, earlier she took the child and dependent care credit and the education credit. Since the remaining tax is less than the \$2,000 credit allowed for two qualifying children, she cannot take the full child tax credit.



**TaxWise Hint:** Since this credit is automatically calculated by TaxWise, based on information about dependents and income already entered on the return, the volunteer does not need to make any additional TaxWise entries. TaxWise will display \$247 on Form 1040, line 51 on the Nonrefundable Credits screen.

**Sample interview explaining Vanessa’s partial child tax credit**

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
Let’s see if you are able to take the full credit. Your modified adjusted gross income of \$27,630 qualifies. It is less than the \$75,000 limit.	Great!
Let’s take a look at your tax. I see your tax on line 46 is \$913. After applicable credits, you are still left with a tax amount that is less than the full \$2,000 credit for both children.	What does that mean?
Well, this credit is limited to the amount of your tax. But you may be eligible for the additional child tax credit. For now, let’s take a look at your Child Tax Credit Worksheet in TaxWise and I can show you how this works.	

The paper version of Vanessa’s Form 1040, Child Tax Credit Worksheet is very similar to what you see in TaxWise. It may help you understand how TaxWise calculates the child tax credit. See the completed worksheet in Appendix B.

**Explanation of Additional Child Tax Credit**

Vanessa did not qualify for the full nonrefundable child tax credit because the credit was more than her tax liability. Next, determine if she is eligible for the additional child tax credit. The Additional Child Tax Credit criteria are shown as a Tip in the Credits section of the Volunteer Resource Guide (Tab G).

Because Vanessa did not use the entire amount of the nonrefundable child tax credit to offset her tax, and her earned income was more than \$12,050, she is eligible to claim the additional child tax credit.



**TaxWise Hint:** TaxWise automatically calculates the child tax credit and the additional child tax credit based on other entries to the return.

Vanessa’s additional child tax credit is \$1,753 as indicated on Form 1040.



Return to Lesson 26.

## Lesson 27 Miscellaneous Credits

### Does Vanessa qualify for the Credit for Qualified Retirement Savings Contribution?

Vanessa may be able to reduce her tax liability if she is able to take this credit. In Part IV, Expenses, of her approved intake and interview sheet, Vanessa answered “yes” to the question about contributions to IRA or other retirement account. Based on her Form W-2, we know Vanessa contributed \$1,000 into her employer plan 401K account. In addition, based on a previous sample interview, she put \$600 into her IRA. Be sure to record this information on her approved intake and interview sheet, as shown here.

#### Part IV. Expenses – Did you (or your spouse) make or have:

- |   |  |   |
|---|--|---|
| <input type="checkbox"/> Yes            | <input checked="" type="checkbox"/> No | 1. Alimony payments (if yes, you must provide the name and SSN of the recipient)          |
| <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No            | 2. Contributions to IRA or other retirement account <i>\$600 IRA, \$1,000 on Form W-2</i> |

Before completing Form 8880, you decided to ask additional probing questions using the Volunteer Resource Guide.

#### Sample interview clarifying the retirement savings contribution

##### SAMPLE INTERVIEW

###### VOLUNTEER SAYS...

*Since you put money into an IRA and your retirement account at work, let's see if you're eligible for the saver's credit. Your AGI isn't too high. And you were born before January 1, 1990?*

*We know that you can't be claimed as a dependent by someone else. And, even though you did take a class; you were not considered a full-time student.*

*During 2006, 2007 or the current tax year, did you take any money out of your IRA account or your 401(k) plan at work?*

*Good, Now I have all the information I need to make the calculation. Let me finish this up and see how much credit you can get.*

###### VANESSA RESPONDS...

Yes, that's right.

That's correct.

No. I try to forget all about them. Once you start taking it out, it's too hard to put it back.

### Computing the Credit for Qualified Retirement Savings Contributions

Vanessa qualifies for the saver's credit. Use a blank Form 8880 to calculate the amount of the credit.

**Credit for Qualified Retirement Savings Contributions**

▶ Attach to Form 1040, Form 1040A, or Form 1040NR.

▶ See instructions on back.

OMB No. 1545-0074

**2008**Attachment  
Sequence No. **55**

Name(s) shown on return

Your social security number

You **cannot** take this credit if **either** of the following applies.

- The amount on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36 is more than \$26,500 (\$39,750 if head of household; \$53,000 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1991, **(b)** is claimed as a dependent on someone else's 2008 tax return, or **(c)** was a **student** (see instructions).

	(a) You	(b) Your spouse
<b>1</b> Traditional and Roth IRA contributions for 2008. <b>Do not</b> include rollover contributions	<b>1</b>	
<b>2</b> Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18)(D) plan contributions for 2008 (see instructions)	<b>2</b>	
<b>3</b> Add lines 1 and 2	<b>3</b>	
<b>4</b> Certain distributions received <b>after</b> 2005 and <b>before</b> the due date (including extensions) of your 2008 tax return (see instructions). If married filing jointly, include <b>both</b> spouses' amounts in <b>both</b> columns. See instructions for an exception	<b>4</b>	
<b>5</b> Subtract line 4 from line 3. If zero or less, enter -0-	<b>5</b>	
<b>6</b> In each column, enter the <b>smaller</b> of line 5 or \$2,000	<b>6</b>	
<b>7</b> Add the amounts on line 6. If zero, <b>stop</b> ; you cannot take this credit		<b>7</b>
<b>8</b> Enter the amount from Form 1040, line 38*; Form 1040A, line 22; or Form 1040NR, line 36	<b>8</b>	
<b>9</b> Enter the applicable decimal amount shown below:		

If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
Enter on line 9—				
---	\$16,000	.5	.5	.5
\$16,000	\$17,250	.5	.5	.2
\$17,250	\$24,000	.5	.5	.1
\$24,000	\$25,875	.5	.2	.1
\$25,875	\$26,500	.5	.1	.1
\$26,500	\$32,000	.5	.1	.0
\$32,000	\$34,500	.2	.1	.0
\$34,500	\$39,750	.1	.1	.0
\$39,750	\$53,000	.1	.0	.0
\$53,000	---	.0	.0	.0

**Note:** If line 9 is zero, **stop**; you cannot take this credit.

<b>10</b> Multiply line 7 by line 9	<b>10</b>	
<b>11</b> Enter the amount from Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 43	<b>11</b>	
<b>12</b> <b>1040 filers:</b> Enter the total of your credits from lines 47 through 50, line 12 of the Line 11 Worksheet in Pub. 972 (see instructions), plus the amounts, if any, from line 13 of Form 8396, line 20 of Form 5695, and line 7 of Form 8859.	<b>12</b>	
<b>1040A filers:</b> Enter the total of your credits from lines 29 through 32.		
<b>1040NR filers:</b> Enter the total of your credits from lines 44 and 45, line 12 of the Line 11 Worksheet in Pub. 972 (see instructions), plus the amounts, if any, from line 13 of Form 8396, line 20 of Form 5695, and line 7 of Form 8859.		
<b>13</b> Subtract line 12 from line 11. If zero, <b>stop</b> ; you cannot take this credit	<b>13</b>	
<b>14</b> <b>Credit for qualified retirement savings contributions.</b> Enter the <b>smaller</b> of line 10 or line 13 here and on Form 1040, line 52; Form 1040A, line 33; or Form 1040NR, line 47	<b>14</b>	

\*See Pub. 590 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

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Cat. No. 33394D

Form **8880** (2008)



Vanessa's credit is computed at 10% (.1) of her total contributions, so her retirement savings credit is \$160. This amount should be inserted on line 52 of Form 1040, page 2. Vanessa's completed Form 8880 is in Appendix B.



**TaxWise Hint:** Because you already entered the amounts from her Form W-2 and the amount contributed to her IRA, TaxWise automatically carries these amounts to Form 8880.



Return to Lesson 27.



## Lesson 28 Other Taxes

### Does Vanessa have any additional taxes?

Vanessa answered “yes” to self-employment income earlier in the interview process. Let’s determine if she has any additional taxes. As you recall, Vanessa has her own cosmetic business.

#### TIP

You may find it helpful to review information in Publication 17, How to Figure Your Tax, when completing the Other Taxes section of the return especially if you’re not using TaxWise.

### Sample interview clarifying additional taxes

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*We are almost finished with your return. We already reported your self-employment income. Did you know that income is subject to social security and Medicare taxes?*

*We can use the short version of Schedule SE since you meet the requirements.*

*Here is the amount of social security and Medicare tax you owe on your self-employment income. We look at your Schedule SE to determine how the amount is calculated. Your self employment income from Schedule C-EZ is \$2,400. After an adjustment to that figure then we multiply the total by 15.3%. The result is \$339. That amount goes on Form 1040, line 57.*

*That’s right. Schedule SE calculates one half of the self-employment tax and it automatically takes that figure to the adjustment section of Form 1040.*

*The next tax is for unreported tip income. Do you receive tips at your regular job or as part of your self-employment?*

*We’ll leave that zero. When we discussed the saver’s credit, you said that you didn’t receive any distributions from an IRA or a retirement plan, is that correct?*

*When I entered your Form W-2 information, I didn’t put anything in box 9, for advance EIC Payment. Let’s double check. Did you receive any advance payments of EIC during 2008?*

*Did you know that you may choose to receive advance payments of the EIC throughout the year rather than waiting until you file your tax return to receive the full amount?*

*You need to fill out Form W-5 and give it to your employer. Then you can receive a portion of the credit in your regular paychecks.*

##### VANESSA RESPONDS...

No, but that is good to know.

Okay.

I see my self-employment income here... and it just calculates the tax here.

I see.

No, not at all.

Yes, that’s right.

No, none.

No, I didn’t. How do I do that?

That sounds like it could help out with the monthly budget. I’ll have to check into that.

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

*Now for the last tax: Did you have any household employees in 2008?*

*Yes, but you do that for free! The Other Taxes section is done.*

*Based on your income, adjustments to income, tax and credits, and other taxes, this amount represents your total tax.*

*No, actually, because of your withholding and your Earned Income Credit, you are due a refund. Shall we go over that now?*

VANESSA RESPONDS...

I sure didn't – unless you count me!

Oh, do I owe that?

Gladly!

Vanessa must pay \$339 in self-employment taxes on her income from her cosmetic business. Her completed Schedule SE in Appendix B reflects this amount and directs the taxpayer to enter the amount in the Other Taxes section of her tax return.



**TaxWise Hint:** TaxWise completes Schedule SE and computes the additional taxes automatically.



Return to Lesson 28.

## Lesson 29 Payments

### Does Vanessa qualify for any additional credits?

After reviewing Part IV, item 8, and the ESP question in Part V of Vanessa's approved intake and interview sheet, you review the Recovery Rebate Credit information in the Volunteer Resource Guide and the Payment section of her return before starting the interview.

Vanessa checked "no" on item 8 in Part IV of her approved intake and interview sheet regarding estimated tax payments. Let's see what payments Vanessa made during the year and if she will qualify for any additional credits that will reduce her tax liability. Her Form W-2 reveals her tax withholding.

### Sample interview clarifying payments

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>We are in the Payments section. TaxWise shows the withholding tax from your Form W-2 of \$1,240.</i>	Okay.
<i>I know you had a little self-employment income. Did you pay estimated tax during 2008?</i>	No, I did not.
<i>Looking at your self-employment income and your last year's return, you probably weren't required to pay any.</i>	That's a relief!
<i>Let me skip the earned income credit entry for now. We decided earlier that you qualify for the additional child tax credit in the amount of \$1,753.</i>	That's correct.
<i>Did you receive the Economic Stimulus Payment during the summer of 2008?</i>	Yes. My husband and I filed jointly last year. We received a check for \$1200. Here is the notice that shows the amount we received.
<i>Based on the ESP amount you received, you will receive an additional \$300 recovery rebate credit. We use a worksheet to figure the credit.</i>	That's great. I can use the extra money.
<i>We're not finished yet. Zoe and Zachary may qualify you for the earned income credit. The EIC may increase your refund or decrease your tax liability.</i>	That's good!

### Computing the credit

Vanessa's credit can be computed using the Recovery Rebate Credit Worksheet in TaxWise or Form 1040 instructions. (See an illustration of the worksheet in the Volunteer Resource Guide on page 13.)

25.	Is the amount on line 23 more than the amount on line 24? <input checked="" type="checkbox"/> <b>No.</b> Skip line 26. Enter the amount from line 22 on line 27 below. <input type="checkbox"/> <b>Yes.</b> Subtract line 24 from line 23	25.	
26.	Multiply line 25 by 5% (.05)	26.	
27.	Subtract line 26 from line 22. If zero or less, enter -0-	27.	900
28.	Enter the amount, if any, of the economic stimulus payment you received (before offset) as shown on Notice 1378. If filing a joint return, include your spouse's payment. If you filed a joint return for 2007 and received an economic stimulus payment, you and your spouse are each treated as having received half of the payment	28.	600
29.	<b>Recovery rebate credit.</b> Subtract line 28 from line 27. If zero or less, enter -0-. Enter the result here and, if more than zero, on Form 1040, line 70. If you entered an amount on line 13 above, enter "VA" on the dotted line to the left of Form 1040, line 70. If line 28 is more than line 27, you do not have to pay back the difference	29.	300

\*A valid social security number is not required for a qualifying child if you filed a joint return AND either you or your spouse was a member of the U.S. Armed Forces at any time during 2008.

Vanessa will receive a \$300 Recovery Rebate Credit. Pay attention to line 28 on the Recovery Rebate Credit Worksheet: Each spouse is treated as having received half of the ESP amount; because Vanessa filed a *joint* return in 2007, and the ESP amount was \$1,200, you enter the amount of \$600 on line 28 of the worksheet.

See Appendix B for Vanessa's completed Form 8812 and the Recovery Rebate Credit Worksheet, and the completed Payment section of her tax return. Remember to enter the \$1,200 ESP amount in Part V of Vanessa's approved intake and interview sheet and note the \$300 Recovery Rebate Credit in the margin.



**TaxWiseHint:** Vanessa's EIC amount is automatically computed along with the federal income tax withheld entry from her Form W-2 and her additional child tax credit amount from Form 8812. TaxWise may also automatically compute the Recovery Rebate Credit.




Return to Lesson 29.

# Lesson 30 Earned Income Credit (EIC)

## Does Vanessa qualify for the EIC?

To determine if Vanessa qualifies for the EIC, you would ask questions based on the EIC General Eligibility Interview Tips found in the Volunteer Resource Guide (Tab H). This helps you find out if she has qualified income, a valid social security number, and other pertinent pieces of information.

 **TaxWiseHint:** TaxWise has already made Vanessa’s EIC computation based on the entries in the Main Information Sheet in the Payment section of her return.

## Sample interview clarifying EIC

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>Are you familiar with the EIC?</i>	Yes, I got it last year.
<i>I need to ask you two questions. Has your request for the credit ever been denied, or the amount reduced by the IRS?</i>	Let me think. “No” to both questions.
<i>Good! Since your income is less than \$38,646, you could qualify for the earned income credit again this year. Let’s see. I already checked and you and the kids all have valid social security cards. And you will file as Head of Household.</i>	That’s right.
<i>Okay. And you are a U.S. citizen, so you weren’t a nonresident alien during the tax year?</i>	No, that’s for sure!
<i>Did you have any income from outside the United States?</i>	No, my only income was from my job and my cosmetics sales.
<i>Very good. Now, because the Income section of your tax return shows that you had no interest, dividend, or capital gains income, we don’t have to worry about your investment income being too high.</i>	Unfortunately not.
<i>And we know that you are not someone else’s qualifying child.</i>	Yes.

Based on the interview, we know that Vanessa meets the general eligibility requirements. Next, you need to determine if one or both of her children is a “qualifying child” for EIC.

## Do Vanessa’s children qualify her for the EIC?

To determine if Vanessa’s children Zoe and Zachary are qualifying children for the EIC, you should question her based on the Interview Tips for EIC with a Qualifying Child in the Volunteer Resource Guide (Tab H).

**Sample interview clarifying EIC with Qualifying Child credit**

**SAMPLE INTERVIEW**

VOLUNTEER SAYS...

VANESSA RESPONDS...

*Lets see, we already know the kids have valid social security numbers, that they are your children and they are under the age of 19.*

Yes, that's correct.

*I am guessing neither one is married?*

[Laughs] No, they're not even dating yet.

*They lived with you in the U.S. for the entire year, so they meet the half-year requirement. To claim children for the EIC, they have to meet age and relationship tests, and live with you in the U.S. for more than half the year. Since your mother lives with you, the kids would also pass those tests for her. Have you talked about this with your mom? Will she be claiming either of the kids for the EIC on her tax return?*

No, I always take both kids.

*Great. If you both accidentally claimed the same kids, the IRS would decide who was entitled according to their tie-breaker rules. As the parent, you would win the tie.*

In Part V of Vanessa's approved intake and interview sheet you would check "Yes" for question 7, "Based on the interview, is the taxpayer qualified for the EIC?"

**Optional Exercise**

Using Vanessa Franklin's information and the worksheets below, complete Vanessa's Schedule EIC and compute her earned income tax credit. Compare your work to the completed forms in Appendix B.



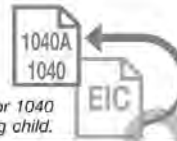
**SCHEDULE EIC**  
**(Form 1040A or 1040)**

Department of the Treasury  
Internal Revenue Service (99)

Name(s) shown on return

**Earned Income Credit**  
**Qualifying Child Information**

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.



OMB No. 1545-0074

**2008**

Attachment  
Sequence No. **43**

Your social security number

- Before you begin:**
- See the instructions for Form 1040A, line 40, or Form 1040, line 65, to make sure that (a) you can take the EIC, and (b) you have a qualifying child.
  - Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.

**Qualifying Child Information**

**Child 1**

**Child 2**

	First name	Last name	First name	Last name
<b>1 Child's name</b> If you have more than two qualifying children, you only have to list two to get the maximum credit.				
<b>2 Child's SSN</b> The child must have an SSN as defined on page 41 of the Form 1040A instructions or page 47 of the Form 1040 instructions unless the child was born and died in 2008. If your child was born and died in 2008 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.				
<b>3 Child's year of birth</b>	Year _____ <i>If born after 1989, skip lines 4a and 4b, go to line 5.</i>		Year _____ <i>If born after 1989, skip lines 4a and 4b, go to line 5.</i>	
<b>4 If the child was born before 1990—</b>				
<b>a</b> Was the child under age 24 at the end of 2008 and a student?	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 5.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue.</i>	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 5.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue.</i>
<b>b</b> Was the child permanently and totally disabled during any part of 2008?	<input type="checkbox"/> <b>Yes.</b> <i>Continue.</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.	<input type="checkbox"/> <b>Yes.</b> <i>Continue.</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.
<b>5 Child's relationship to you</b> (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)				
<b>6 Number of months child lived with you in the United States during 2008</b> <ul style="list-style-type: none"><li>• If the child lived with you for more than half of 2008 but less than 7 months, enter "7."</li><li>• If the child was born or died in 2008 and your home was the child's home for the entire time he or she was alive during 2008, enter "12."</li></ul>	_____ months <i>Do not enter more than 12 months.</i>		_____ months <i>Do not enter more than 12 months.</i>	



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2008, and (b) is a U.S. citizen or resident alien. For more details, see the instructions for line 41 of Form 1040A or line 67 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2008



## Lines 65a and 65b— Earned Income Credit (EIC)

### What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

### To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.

For help in determining if you are eligible for the EIC, go to [www.irs.gov/eite](http://www.irs.gov/eite) and click on "EITC Assistant." This service is available in English and Spanish.



*If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. See Form 8862, who must file, on page 47. You may also have to pay penalties.*

### Step 1 All Filers

- If, in 2008:
  - 2 children lived with you, is the amount on Form 1040, line 38, less than \$38,646 (\$41,646 if married filing jointly)?
  - 1 child lived with you, is the amount on Form 1040, line 38, less than \$33,995 (\$36,995 if married filing jointly)?
  - No children lived with you, is the amount on Form 1040, line 38, less than \$12,880 (\$15,880 if married filing jointly)?

☐ **Yes.** Continue ☐ **No.** You cannot take the credit.
- Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 47)?
 

☐ **Yes.** Continue ☐ **No.** You cannot take the credit. Enter "No" on the dotted line next to line 65a.
- Is your filing status married filing separately?
 

☐ **Yes.** You cannot take the credit. ☐ **No.** Go to question 4.

- Are you filing Form 2555 or 2555-EZ (relating to foreign earned income)?
 

☐ **Yes.** You cannot take the credit. ☐ **No.** Continue

- Were you or your spouse a nonresident alien for any part of 2008?
 

☐ **Yes.** See *Nonresident aliens* on page 47. ☐ **No.** Go to Step 2.

### Step 2 Investment Income

- Add the amounts from Form 1040:

Line 8a		_____
Line 8b	+	_____
Line 9a	+	_____
Line 13*	+	_____

Investment Income =

\*If line 13 is a loss, enter -0-.

- Is your investment income more than \$2,950?
 

☐ **Yes.** Continue ☐ **No.** Skip question 3; go to question 4.
- Are you filing Form 4797 (relating to sales of business property)?
 

☐ **Yes.** See *Form 4797 filers* on page 47. ☐ **No.** You cannot take the credit.
- Do any of the following apply for 2008?
  - You are filing Schedule E.
  - You are reporting income from the rental of personal property not used in a trade or business.
  - You are reporting income on Form 1040, line 21, from Form 8814 (relating to election to report child's interest and dividends).

☐ **Yes.** You must use Worksheet 1 in Pub. 596 to see if you can take the credit. ☐ **No.** Go to Step 3.

Need more information or forms? See page 82.

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Continued from page 44

**Step 3 Qualifying Child****A qualifying child for the EIC is a child who is your...**

Son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your grandchild, niece, or nephew)

**AND****was ...**

Under age 19 at the end of 2008

or

Under age 24 at the end of 2008 and a student (see page 47)

or

Any age and permanently and totally disabled (see page 47)

**AND****who...**

Lived with you in the United States for more than half of 2008.

If the child did not live with you for the required time, see *Exception to time lived with you* on page 47.



**CAUTION** If the child meets the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2008, or the child was married, see page 47.

1. Do you have at least one child who meets the conditions to be your qualifying child?
- ☐ **Yes.** The child must have a valid social security number as defined on page 47 unless the child was born and died in 2008. Go to question 2.
- ☐ **No.** Skip question 2; go to Step 4.

2. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2008?

☐ **Yes.** **STOP**

You cannot take the credit. Enter "No" on the dotted line next to line 65a.

☐ **No.** Skip Step 4; go to Step 5 on page 46.**Step 4 Filers Without a Qualifying Child**

1. Is the amount on Form 1040, line 38, less than \$12,880 (\$15,880 if married filing jointly)?
- ☐ **Yes.** Continue → ☐ **No.** **STOP**  
You cannot take the credit.
2. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2008?
- ☐ **Yes.** **STOP** ☐ **No.** Continue →  
You cannot take the credit. Enter "No" on the dotted line next to line 65a.
3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2008 tax return?
- ☐ **Yes.** **STOP** ☐ **No.** Continue →  
You cannot take the credit.
4. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2008?
- ☐ **Yes.** Continue → ☐ **No.** **STOP**  
You cannot take the credit.
5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2008? Members of the military stationed outside the United States, see page 47 before you answer.
- ☐ **Yes.** Go to Step 5 on page 46. ☐ **No.** **STOP**  
You cannot take the credit. Enter "No" on the dotted line next to line 65a.

Continued from page 45

**Step 5 Earned Income**

1. Are you filing Schedule SE because you were a member of the clergy or you had church employee income of \$108.28 or more?

☐ **Yes.** See *Clergy or Church employees*, whichever applies, on this page. ☐ **No.** Continue →

2. Figure earned income:

Form 1040, line 7

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2,
- Amount received for work performed while an inmate in a penal institution (enter "PRI" and the amount subtracted on the dotted line next to Form 1040, line 7),
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (enter "DFC" and the amount subtracted on the dotted line next to Form 1040, line 7). This amount may be shown in box 11 of Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Add all of your nontaxable combat pay if you elect to include it in earned income. Also enter this amount on Form 1040, line 65b. See *Combat pay, nontaxable* on this page.



**CAUTION** Electing to include nontaxable combat pay may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election.

**Earned Income** =

3. Were you self-employed at any time in 2008, or are you filing Schedule SE because you were a member of the clergy or you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

☐ **Yes.** Skip question 4 and Step 6; go to Worksheet B on page 49. ☐ **No.** Continue →

4. If you have:

- 2 or more qualifying children, is your earned income less than \$38,646 (\$41,646 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$33,995 (\$36,995 if married filing jointly)?
- No qualifying children, is your earned income less than \$12,880 (\$15,880 if married filing jointly)?

**Need more information or forms? See page 82.**

☐ **Yes.** Go to Step 6.

☐ **No.** **STOP**

You cannot take the credit.

**Step 6 How To Figure the Credit**

1. Do you want the IRS to figure the credit for you?

☐ **Yes.** See *Credit figured by the IRS* below. ☐ **No.** Go to Worksheet A on page 48.

**Definitions and Special Rules**

(listed in alphabetical order)

**Adopted child.** An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

**Church employees.** Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 5a. Subtract that amount from the amount on Form 1040, line 7, and enter the result in the first space of Step 5, line 2. Be sure to answer "Yes" to question 3 in Step 5.

**Clergy.** The following instructions apply to ministers, members of religious orders who have not taken a vow of poverty, and Christian Science practitioners. If you are filing Schedule SE and the amount on line 2 of that schedule includes an amount that was also reported on Form 1040, line 7:

1. Enter "Clergy" on the dotted line next to Form 1040, line 65a.
2. Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 2.
3. Subtract that amount from the amount on Form 1040, line 7. Enter the result in the first space of Step 5, line 2.
4. Be sure to answer "Yes" to question 3 in Step 5.

**Combat pay, nontaxable.** If you were a member of the U.S. Armed Forces who served in a combat zone, certain pay is excluded from your income. See *Combat Zone Exclusion* in Pub. 3. You can elect to include this pay in your earned income when figuring the EIC. The amount of your nontaxable combat pay should be shown in box 12 of Form(s) W-2 with code Q. If you are filing a joint return and both you and your spouse received nontaxable combat pay, you can each make your own election.

**Credit figured by the IRS.** To have the IRS figure your EIC:

1. Enter "EIC" on the dotted line next to Form 1040, line 65a.
2. Be sure you enter the nontaxable combat pay you elect to include in earned income on Form 1040, line 65b. See *Combat pay, nontaxable* above.
3. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, who must file on page 47.

**Exception to time lived with you.** A child is considered to have lived with you for all of 2008 if the child was born or died in 2008 and your home was this child's home for the entire time he or she was alive in 2008. Temporary absences by you or the child for special circumstances, such as school, vacation, business, medical care, military service, or detention in a juvenile facility, count as time the child lived with you. Also see *Kidnapped child* on page 17 or *Members of the military* below.

**Form 4797 filers.** If the amount on Form 1040, line 13, includes an amount from Form 4797, you must use Worksheet 1 in Pub. 596 to

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# Worksheet B—Earned Income Credit (EIC)—Lines 65a and 65b

Keep for Your Records



Use this worksheet if you answered “Yes” to Step 5, question 3, on page 46.

- ✓ Complete the parts below (Parts 1 through 3) that apply to you. Then, continue to Part 4.
- ✓ If you are married filing a joint return, include your spouse’s amounts, if any, with yours to figure the amounts to enter in Parts 1 through 3.

## Part 1

### Self-Employed, Members of the Clergy, and People With Church Employee Income Filing Schedule SE

1a. Enter the amount from Schedule SE, Section A, line 3, or Section B, line 3, whichever applies.	1a	
b. Enter any amount from Schedule SE, Section B, line 4b, and line 5a.	+	1b
c. Combine lines 1a and 1b.	=	1c
d. Enter the amount from Schedule SE, Section A, line 6, or Section B, line 13, whichever applies.	-	1d
e. Subtract line 1d from 1c.	=	1e

## Part 2

### Self-Employed NOT Required To File Schedule SE

For example, your net earnings from self-employment were less than \$400.

2. Do not include on these lines any statutory employee income, any net profit from services performed as a notary public, or any amount exempt from self-employment tax as the result of the filing and approval of Form 4029 or Form 4361.		
a. Enter any net farm profit or (loss) from Schedule F, line 36, and from farm partnerships, Schedule K-1 (Form 1065), box 14, code A*.	2a	
b. Enter any net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1*.	+	
c. Combine lines 2a and 2b.	=	2c

\*Reduce any Schedule K-1 amounts by any partnership section 179 expense deduction claimed, unreimbursed partnership expenses claimed, and depletion claimed on oil and gas properties. If you have any Schedule K-1 amounts, complete the appropriate line(s) of Schedule SE, Section A. Enter your name and social security number on Schedule SE and attach it to your return.

## Part 3

### Statutory Employees Filing Schedule C or C-EZ

3. Enter the amount from Schedule C, line 1, or Schedule C-EZ, line 1, that you are filing as a statutory employee.	3
---	---

## Part 4

### All Filers Using Worksheet B

Note. If line 4b includes income on which you should have paid self-employment tax but did not, we may reduce your credit by the amount of self-employment tax not paid.

4a. Enter your earned income from Step 5 on page 46.	4a
b. Combine lines 1e, 2c, 3, and 4a. This is your total earned income.	4b

If line 4b is zero or less, You cannot take the credit. Enter “No” on the dotted line next to line 65a.

5. If you have:
- 2 or more qualifying children, is line 4b less than \$38,646 (\$41,646 if married filing jointly)?
  - 1 qualifying child, is line 4b less than \$33,995 (\$36,995 if married filing jointly)?
  - No qualifying children, is line 4b less than \$12,880 (\$15,880 if married filing jointly)?
- ☐ Yes. If you want the IRS to figure your credit, see page 46. If you want to figure the credit yourself, enter the amount from line 4b on line 6 (page 50).
- ☐ No. You cannot take the credit. Enter “No” on the dotted line next to line 65a.

**Part 5****All Filers Using Worksheet B**

6. Enter your total earned income from Part 4, line 4b, on page 49.

6	
---	--

7. Look up the amount on line 6 above in the EIC Table on pages 51–58 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

7	
---	--

If line 7 is zero, You cannot take the credit. Enter "No" on the dotted line next to line 65a.

8. Enter the amount from Form 1040, line 38.

8	
---	--

9. Are the amounts on lines 8 and 6 the same?

- ☐ **Yes.** Skip line 10; enter the amount from line 7 on line 11.  
☐ **No.** Go to line 10.

**Part 6****Filers Who Answered "No" on Line 9**

10. If you have:

- No qualifying children, is the amount on line 8 less than \$7,200 (\$10,200 if married filing jointly)?
- 1 or more qualifying children, is the amount on line 8 less than \$15,750 (\$18,750 if married filing jointly)?

☐ **Yes.** Leave line 10 blank; enter the amount from line 7 on line 11.

☐ **No.** Look up the amount on line 8 in the EIC Table on pages 51–58 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 10 and 7. Then, enter the **smaller** amount on line 11.

10	
----	--

**Part 7****Your Earned Income Credit**

**This is your earned income credit.**

**Reminder—**

- ✓ If you have a qualifying child, complete and attach Schedule EIC.



11	
----	--

Enter this amount on Form 1040, line 65a.



If your EIC for a year after 1996 was reduced or disallowed, see page 47 to find out if you must file Form 8862 to take the credit for 2008.



## Lesson 31 Refund/Amount of Tax Owed

### Will Vanessa receive a refund or pay additional tax?

Whether Vanessa receives a refund or owes taxes depends on two entries on her Form 1040: the Total Tax listed in the Other Taxes Section and the Total Payments listed in the Payments Section.

60 Additional taxes: <input type="checkbox"/> AEIC payments <input type="checkbox"/> Household employment taxes. Attach Schedule H					
61 Add lines 56 through 60. This is your <b>total tax</b>		61	339	00	
<b>Payments</b>	62 Federal income tax withheld from Forms W-2 and 1099	62	1,240	00	
	63				
70 Recovery rebate credit (see worksheet on page xx)		70	300	00	
71 Add lines 62 through 70. These are your <b>total payments</b>		71	5,488	00	
<b>Refund</b>	72 If line 71 is more than line 61, subtract line 61 from line 71. This is the amount you <b>overpaid</b>	72	5,149	00	

If her total payments are more than her total tax, she will receive a refund; if her total payments are less than her total tax, she will owe an amount. As you can see from her Form 1040, Vanessa overpaid her taxes and may receive the refund.

To help you complete this part of the return, including the Direct Deposit and balance due guidance, refer to the Volunteer Resource Guide (Tab 13).



**TaxWise Hint:** TaxWise automatically calculates the taxpayer's refund or amount owed.

### Sample interview on refund options

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*Your payments exceeded your tax liability for the year by \$5,149. You can receive the entire amount as a refund, or apply any portion of it to your 2009 estimated taxes.*

*Okay, then we'll leave the line for Applying Your Refund to Next Year's Estimated Taxes blank. Now, would you like to receive your refund via direct deposit? It's much faster than by mail, and there's no charge.*

*Great. The IRS will deposit the refund directly to your account, or as many as three different accounts if you want.*

*As long as you have the routing number and account numbers for each separate account.*

*Great. Now just to make sure we get the numbers right, I'm going to have you look at them on the screen, and then check them again when the return prints out. So keep those numbers handy.*

##### VANESSA RESPONDS...

I think I'd like to take the refund. Zoe and Zachary need some new clothes.

Yes, I'd like that.

Really? I'm trying to put a little of each tax refund in my IRA every year. It's easier to save if I don't really see it. Can I put \$1,000 in my IRA and the rest in checking?

I have them right here.

Sure.

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

*OK, that should do it. \$1,000 in the IRA account and the rest in checking. If your refund changes for any reason, you will receive a notice of explanation from the IRS.*

VANESSA RESPONDS...

That was easy. Thank you.

Because Vanessa does not want any of the refund applied to her 2009 estimated taxes, you would leave that line blank. If Vanessa wanted to direct deposit her refund into one account you would fill in the appropriate lines in the Refund section of the return. However, since Vanessa states she is splitting her refund with part going to her IRA and the other part going into checking, Form 8888 must be completed. When Form 8888 is completed, do not enter any direct deposit information on Page 2 of Form 1040.



**TaxWise Hint:** To complete Form 8888 for Vanessa, add the form to her return.

Complete the information for both of her routing and account numbers and for the amount that goes into each account. Be sure the two amounts total the refund amount. You can print the form for the client's review before submitting the return to the IRS.

If, instead of a refund, Vanessa owed money and could not pay it by April 15, she could pay by credit card, or she could request a payment plan with the IRS. There may be applicable fees, penalties, and interest to consider. The Volunteer Resource Guide (Tab 13) Balance Due Returns outlines the options.

To review these parts of Vanessa's return, go to Appendix B and examine the Refund and Amount You Owe sections of her Form 1040 and her Form 8888.



**Return to Lesson 31.**



## Lesson 32 Completing the Return and Performing a Quality Review

### Vanessa's Quality Review

Vanessa Franklin's tax return is ready for the final quality check to ensure that her tax return is correct and complete. Begin by explaining to her the purpose of the quality review, along with the steps in the process. Next, conduct the review or send Vanessa to your site's quality reviewer.

During the quality review, use the Quality Review sheet which is included in Form 13614-C, Intake/Interview & Quality Review Sheet, or an approved quality review sheet. The Volunteer Resource Guide, Tab 13, offers assistance with this process. See the section, Check Your Work – The Quality Review.

Finally, if Vanessa chooses to e-file, guide her through the process of signing the return electronically.

### Sample interview during quality review and e-filing

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	VANESSA RESPONDS...
<i>I'm looking at your tax return. It has your name and address at the top. Your SSN is 111-11-5555. Take a look at these and make sure they are correct.</i>	Yes, they are.
<i>And could you check the SSNs listed for your children and make sure they are correct?</i>	Yes, those are correct.
<i>Here are the final numbers. The summary screen shows your total income of \$28,400, adjusted gross income of \$27,630, and a computed tax of \$339. Your refund amount is \$5,149.</i>	That's a lot of numbers, but they sound about right. Should I sign the return now?
<i>Well, when e-filing the return it is signed electronically using either a Self-Select PIN or a Practitioner PIN. You create a five-digit personal identification number, or PIN, and type it into TaxWise. I just need your adjusted gross income from last year. Did you bring your tax return from 2007? The AGI will be on the last line on the first page.</i>	Yes. Let's see... oh, here it is, it was \$23,500.
<i>Okay, as long as we have last year's AGI or the PIN you used last year, you qualify for the Self-Select PIN.</i>	What is the other option?
<i>The other option is a Practitioner PIN which requires me to complete and have you sign a Form 8879, which authorizes me to input an electronic signature on your behalf.</i>	Fill out another form? No, that's okay. Can I type in any number? How about my zip code?
<i>The first number can't be a zero. Other than that, the PIN can be any five-digit number you want. Using your ZIP code is a good idea.</i>	Okay. [types in number]
<i>Great! That does it. Now I'll print you a copy for your records.</i>	Wonderful, thank you for your help!

Vanessa should leave the site with all of her documents in addition to a copy of the return and all of the schedules, forms and worksheets.



Return to Lesson 32

## Lesson 33 Concluding the Interview

### How do I conclude the process with the taxpayer?

Based on the Interview Tips for the five-step interview process found at the front of the Volunteer Resource Guide, you're ready to conclude the interview with Vanessa. The final step includes advising Vanessa of the requirements for maintaining her records, how she should address an overpayment, when she will receive her refund, and how to avoid paying additional tax in future tax years.

Before parting, ask Vanessa if she has any final questions. You can find many answers on the inside back cover of the Volunteer Resource Guide; look for "Frequent Taxpayer Inquiries."

#### TIP

Ask your Site Coordinator if you may provide taxpayers with an envelope (Publication 730) they can use to store their tax documents. The envelope includes important information such as how to check the status of the refund.

### Sample interview concluding the tax preparation process

#### SAMPLE INTERVIEW

##### VOLUNTEER SAYS...

*Here's a full copy of the tax return to keep for your records.*

*We keep copy B of your Form W-2 until December 31, and then we shred it. I'll staple the other copies of the W-2 to your copy of the return. We can put everything in this envelope, and you can put your other records and receipts in there too. If you ever need to review the return, everything will be in one place.*

*If you bring this copy back with you next year, it will help the volunteer preparer who does your return.*

*I've created the e-file of your return. Later tonight, the site coordinator will transmit it to the IRS. If there are any problems with the e-file, she usually finds out the next day. If she needs to call you tomorrow, will you be at one of the phone numbers you gave me earlier?*

*Great. She'll only call if she needs information from you to resolve a problem. See this chart in your packet? If everything goes as expected, you can start looking for your direct deposits by this date (show Vanessa the 2009 IRS e-file Refund Cycle chart in the Volunteer Resource Guide, Tab 14).*

*Give it at least one more week – direct deposits always show up on a Friday. If it's still not there, you can call the IRS Refund Hotline. The number is right here on your envelope. There are some other IRS numbers on there, too, if you ever need them. Do you have any other questions?*

*I'm glad I got to meet you. Thanks for coming in!*

##### VANESSA RESPONDS...

*What about my W-2?*

*That's convenient.*

*Okay.*

*I'll be at my work number during the day, and there's an answering machine at home.*

*That's pretty fast. What should I do if it's not there?*

*No, this was pretty easy.*

Thank Vanessa for coming to your site and remind her of where and how to check the status of her return using [IRS.gov](https://www.irs.gov).



Return to Lesson 33.

## Notes

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

[illegible]

## Appendix B: Vanessa's Tax Documents

Form <b>13614-C</b> (September 2008)	Department of the Treasury – Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB # 1545-1964
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**You (and Spouse) will need:**

- Proof of Identity *driver license*
- Social Security Card or Individual Tax Identification Number (ITIN) letter for all individuals to be listed on the return *yes*
- Copies of ALL W-2, 1098, 1099 forms *yes*
- Amounts of any other income *business income (TRBD)*
- Child care provider's identification number *n/a*
- Amounts/dates of estimated or other tax payments made, etc. *n/a*
- Bank documents showing routing and account numbers if requesting direct deposit/debit *yes*

**Part I: Taxpayer Information**

1. Your First Name <b>Vanessa</b>		M.I. <b>L.</b>	Last Name <b>Franklin</b>		2. Date of Birth (mm/dd/yyyy) <b>11/12/1972</b>
3. US Citizen or Resident Alien <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	4. Legally Blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	5. Totally and Permanently Disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		6. Occupation <b>Retail Sales</b>	
7. Spouse's First Name <b>Harvey</b>		M.I. <b>M.</b>	Last Name <b>Franklin</b>		8. Date of Birth (mm/dd/yyyy) <b>07/14/1969</b>
9. US Citizen or Resident Alien <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	10. Legally Blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	11. Totally and Permanently Disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		12. Occupation <b>Cook</b>	
13. Address <b>3344 Cleveland Drive</b>		Apt #	City <b>Denver</b>		State Zip Code <b>CO 80202</b>
14. Phone Number and e-mail address Phone: ( 303 ) 555-5555 e-mail:			15. Could you or your spouse be claimed as a dependent on the income tax return of any other person? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
16. On December 31 <sup>st</sup>					
a. Were you: <input type="checkbox"/> Single <input checked="" type="checkbox"/> Legally Married <input type="checkbox"/> Separated <input type="checkbox"/> Divorced <input type="checkbox"/> Widowed					
b. If married, did you live with your spouse during any part of the last six months of the year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No					
c. Is your spouse deceased? If yes, provide the date of death. <i>n/a</i> (mm/dd/yyyy)					

**Part II. Family and Dependent Information – Do not include you or your spouse.**

Print the name of everyone who lived in your home and outside your home that you supported during the year.

Name (first, last)	Date of Birth mm/dd/yyyy	Relationship to you (son, daughter, etc.)	Number of months person lived with you last year	US Citizen, Resident of US, Canada or Mexico (yes or no)	Is the dependent a full time student? (yes or no)
(a)	(b)	(c)	(d)	(e)	(f)
Zachary Franklin	09/07/1999	son	12	Yes	Yes
Zoe Franklin	12/15/2003	daughter	12	Yes	No
Annabelle Johnson	11/15/1936	<u>mother</u>	12	Yes	No

**Paperwork Reduction Act Notice**

The Paperwork Reduction Act requires that the IRS display an OMB control number on all public information requests. The OMB Control Number for this study is 1545-1964. Also, if you have any comments regarding the time estimates associated with this study or suggestion on making this process simpler, please write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W.CAR.MP:T.T.SP, 1111 Constitution Ave. NW, Washington, DC 20224.

Catalog Number 52121E

Form **13614-C** (9-2008)

**Please Complete Page 2, except Part V. A Certified Volunteer will confirm the information with you.**



## COMMON INCOME AND EXPENSES

### Part III. Income – Did you (or your spouse) receive:

- ☒ Yes ☐ No 1. Wages or Salary (include W-2s for all jobs worked during the year) *Wages = \$26,000*
- ☐ Yes ☒ No 2. Tip income
- ☐ Yes ☒ No 3. Interest/Dividends from: checking or savings account, bonds, CDs, or brokerage account
- ☐ Yes ☒ No 4. State tax refund (may be taxable if you itemized last year)
- ☒ Yes ☐ No 5. Self Employment Income - business, farm, hobby, 1099-Misc or any earned income not reported on W-2 *Total income \$2,990, expenses \$590*
- ☐ Yes ☒ No 6. Alimony income
- ☐ Yes ☒ No 7. Sale of Stock, Bonds or Real Estate
- ☐ Yes ☒ No 8. Disability income
- ☐ Yes ☒ No 9. Pensions, Annuities, and/or IRA distributions
- ☒ Yes ☐ No 10. Unemployment (1099-G) *Husband unemployment income*
- ☐ Yes ☒ No 11. Social Security or Railroad Retirement Benefits (1099-SSA or RRB)
- ☐ Yes ☒ No 12. Other Income: Identify *n/a*

### Part IV. Expenses – Did you (or your spouse) make or have:

- ☐ Yes ☒ No 1. Alimony payments (if yes, you must provide the name and SSN of the recipient)
- ☒ Yes ☐ No 2. Contributions to IRA or other retirement account *\$600 IRA, \$1,000 on Form W-2*
- ☒ Yes ☐ No 3. Educational expenses for you, your spouse and/or dependents *\$430*
- ☒ Yes ☐ No 4. Un-reimbursed medical expenses *\$604*
- ☐ Yes ☒ No 5. Home mortgage payments (interest and taxes – see Form 1098)
- ☒ Yes ☐ No 6. Charitable contributions *\$200*
- ☒ Yes ☐ No 7. Child/dependent care expenses that allow you (and your spouse - if married) to work *\$1500*
- ☐ Yes ☒ No 8. Any estimated tax payments for this tax year
- ☐ Yes ☒ No 9. Was EIC previously disallowed? (if yes, you may not be eligible for EIC)

## Part V. For Completion by a Certified Volunteer

**Volunteer Preparer Instructions:** You must conduct a thorough interview to complete an accurate return. This Intake/Interview Sheet is the start of your conversation with the taxpayer. Use the decision trees in Publication 4012, Volunteer Resource Guide, while discussing the questions on this form. **Remember to ask for all documentation.** Update the Intake/Interview Sheet with any changes identified during your interview. Confirm all information with the taxpayer.

- ☐ Yes ☒ No 1. Did any of these dependents file a joint return for this tax year?
- ☐ Yes ☒ No 2. Can anyone else claim any of these dependents on their income tax return?
- ☐ Yes ☒ No 3. Did any dependent on the return provide more than 50% of their own support?
- ☐ Yes ☒ No 4. Were any of these dependents permanently and totally disabled last year?
- ☐ Yes ☒ No 5. Did the taxpayer provide over half the support for each of these dependents?
- 2 6. Based on the interview, how many individuals qualify as dependents for this return? *not her mother*
- ☒ Yes ☐ No 7. Based on the interview, does the taxpayer qualify for EIC?

Based on the interview, the filing status of the taxpayer is: ☐ Single ☐ MFJ ☐ MFS\* ☒ HOH ☐ QW

\*If MFS, then spouse's name and SSN should be included on the tax return.

Did the taxpayer receive an Economic Stimulus Payment last year?

☒ Yes ☐ No If yes, how much? *\$1200*

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## Interview Notes

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Mrs. Franklin provided letter from SSA and SSA cards for all individuals on the return and documentation as stated in the margins. I confirmed all her entries on this form; see notes in margins. Although her mother lived with her for 12-months, she paid over half of her total expenses (\$3800) for the year.

Mrs. Franklin paid only \$1900 of her mother's expenses. She does not wish to file her return with her husband and she meets the requirements for HOH filing status, which is more advantageous for Mrs. Franklin.

Her itemized deductions are less than her standard deduction amount. She's taking the standard deduction.

The CTC worksheet in Pub. 972 was required to complete her return and she qualifies for a RRC.

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## Quality Reviewer, please complete Page 4

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### Quick & Easy Access to Tax Help & Forms

**[www.irs.gov](http://www.irs.gov)**

Tax Information & Assistance: 1-800-829-1040

Forms & Publications: 1-800-829-3676

Tele-Tax Information Line: 1-800-829-4477

Taxpayer Advocate: 1-877-777-4778



## Quality Review



This form is used to Quality Review the completed tax return based on the Intake/Interview Sheet, the documents provided for the return preparation, and a conversation with the taxpayer.

- Involve the taxpayer in the Quality Review process.
- Complete this form prior to obtaining the taxpayer's signature on required tax forms.
- Compare the completed return with the Intake/Interview Sheet and all supporting documents.

**Quality Reviews complete the Quality Process and help ensure an accurate return.**

### Verifying the Return


*Check each item only when you verify that the review step is complete.*

1. ☒ Yes ☐ No A completed **Intake/Interview Sheet** was used to prepare this tax return.
2. ☒ Yes ☐ No **Name(s) and SSNs/ITINs** for taxpayer(s) match the supporting documents.
3. ☒ Yes ☐ No **The taxpayer(s) address and Date of Birth** match the Intake/Interview Sheet and have been confirmed with the taxpayer.
4. ☒ Yes ☐ No **Filing status** was correctly determined and is notated on the Intake/Interview Sheet.
5. ☒ Yes ☐ No **Dependent information** is correctly shown including names, SSNs/ITINs, and DOBs.
6. ☒ Yes ☐ No All **income** indicated on the Intake/Interview Sheet and W-2s/1099s is shown.
7. ☒ Yes ☐ No Any **Adjustments to Income** are correctly reported.
8. ☒ Yes ☐ No The completed return reflects the correct **standard deduction** unless itemized deductions were used. If **itemized deductions** were used, the Schedule A has been completed accurately based on supporting documents.
9. ☒ Yes ☐ No The **non-refundable credits** have been correctly reported.
10. ☒ Yes ☐ No All payments from **W-2s and F1099's** and estimated tax payments are correct.
11. ☒ Yes ☐ No The **refundable credits** are correctly reported including the EIC determination based on the information provided.
12. ☒ Yes ☐ No If **direct deposit or debit** was elected, information on the return matches the taxpayer's checking/saving account and routing information.

### Finishing the Return

*Check the appropriate box once you have confirmed the steps have been taken.*

- ☒ **E-File:** Verify correct **DCN and SIDN** is printed on Form 8879. Obtain taxpayer signature and provide a copy of the return for their files. Retain original signed Form 8879 with the Forms W-2's and 1099's attached.
- ☐ **Paper:** Verify the correct **SIDN** is printed on the return. Attach Forms W-2's and 1099's to the return. Obtain taxpayer signature and provide the signed return, a copy of the return, and the correct processing center mailing address to the taxpayer.
- ☒ All taxpayer questions/issues about the completed return have been answered.

a Employee's social security number <b>111-11-5555</b>		Safe, accurate, FAST! Use  Visit the IRS website at <a href="http://www.irs.gov/efile">www.irs.gov/efile</a> .	
b Employer identification number (EIN) <b>39-9999999</b>		1 Wages, tips, other compensation <b>26,000</b>	2 Federal income tax withheld <b>1,240</b>
c Employer's name, address, and ZIP code  <b>Bob's Department Store PO Box 456 Denver, CO 80204</b>		3 Social security wages <b>27,000</b>	4 Social security tax withheld <b>1,674</b>
		5 Medicare wages and tips <b>27,000</b>	6 Medicare tax withheld <b>392</b>
		7 Social security tips	8 Allocated tips
d Control number		9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial Last name Suff.  <b>Vanessa L. Franklin 3344 Cleveland Drive Denver, CO 80202</b>		11 Nonqualified plans	12a See instructions for box 12 <b>D</b> <b>1,000</b>
		13 Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/>	12b
		14 Other	12c
			12d
f Employee's address and ZIP code			
15 State <b>CO</b>	Employer's state ID number <b>39-0000000</b>	16 State wages, tips, etc. <b>26,000</b>	17 State income tax <b>257</b>
		18 Local wages, tips, etc.	19 Local income tax
		20 Locality name	

Form **W-2** Wage and Tax Statement

**2008**

Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.  
This information is being furnished to the Internal Revenue Service.

☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number <b>Bates University 44 Main Street Denver, CO 80201</b>		1 Payments received for qualified tuition and related expenses <b>\$ 530</b>	OMB No. 1545-1574 <b>2008</b> Form <b>1098-T</b>	<b>Tuition Statement</b>
		2 Amounts billed for qualified tuition and related expenses <b>\$</b>		
FILER'S federal identification no. <b>39-111xxxxxx</b>	STUDENT'S social security number <b>111-11-5555</b>	3 If this box is checked, your educational institution has changed its reporting method for 2008 <input type="checkbox"/>		<b>Copy B For Student</b>  This is important tax information and is being furnished to the Internal Revenue Service.
STUDENT'S name <b>Vanessa L Franklin</b>		4 Adjustments made for a prior year <b>\$</b>	5 Scholarships or grants <b>\$</b>	
Street address (including apt. no.) <b>3344 Cleveland Dr</b>		6 Adjustments to scholarships or grants for a prior year <b>\$</b>	7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2009 <input type="checkbox"/>	
City, state, and ZIP code <b>Denver, CO 80202</b>		9 Checked if a graduate student <input type="checkbox"/>	10 Ins. contract reimb./refund <b>\$</b>	
Service Provider/Acct. No. (see instr.)	8 Checked if at least half-time student <input type="checkbox"/>			

Form **1098-T** (keep for your records) Department of the Treasury - Internal Revenue Service

**Citizen's  
Credit Union  
Individual Retirement Account (IRA)**

Account Holder: Vanessa L. Franklin

Routing Number: 325272021

Account Number: 1111

**Vanessa L. Franklin**  
3344 Cleveland Drive  
Denver, CO 80202

**1234**  
12-0003

PAY TO THE  
ORDER OF

20

\$

DOLLARS

**First City Bank**  
11 Main Street  
Denver, CO 80201

For

:125200691 : 999999 000000001234



Form **1040**

Department of the Treasury—Internal Revenue Service

**U.S. Individual Income Tax Return** **2008**

(99) IRS Use Only—Do not write or staple in this space.

**Label**

(See instructions on page 12.)

**Use the IRS label.** Otherwise, please print or type.**Presidential****Election Campaign**

For the year Jan. 1–Dec. 31, 2008, or other tax year beginning 2008, ending 20		OMB No. 1545-0074
Your first name and initial <b>Vanessa L.</b>	Last name <b>Franklin</b>	Your social security number <b>111 11 5555</b>
If a joint return, spouse's first name and initial Last name		Spouse's social security number
Home address (number and street). If you have a P.O. box, see page 12. <b>3344 Cleveland Dr</b>		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. <b>Denver, CO 80202</b>		▲ You must enter your SSN(s) above. ▲
Check here if you, or your spouse if filing jointly, want \$3 to go to this fund (see page 12) ▶		Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse

**Filing Status**

Check only one box.

- 1 ☐ Single
- 2 ☐ Married filing jointly (even if only one had income)
- 3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
- 4 ☒ Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
- 5 ☐ Qualifying widow(er) with dependent child (see page 14)

**Exemptions**

If more than four dependents, see page 15.

6a <input checked="" type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a				Boxes checked on 6a and 6b	1
b <input type="checkbox"/> Spouse				No. of children on 6c who:	2
c Dependents:				• lived with you	
				• did not live with you due to divorce or separation (see page 16)	
(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 15)	Dependents on 6c not entered above	
<b>Zoe Franklin</b>	<b>111 11 7777</b>	<b>Daughter</b>	<input checked="" type="checkbox"/>		
<b>Zachary Franklin</b>	<b>111 11 9999</b>	<b>Son</b>	<input checked="" type="checkbox"/>		
d Total number of exemptions claimed				Add numbers on lines above ▶	3

**Income**

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see page 19.

Enclose, but do not attach, any payment. Also, please use Form 1040-V.

7 Wages, salaries, tips, etc. Attach Form(s) W-2	7	26,000	00
8a Taxable interest. Attach Schedule B if required	8a		
b Tax-exempt interest. Do not include on line 8a	8b		
9a Ordinary dividends. Attach Schedule B if required	9a		
b Qualified dividends (see page 19)	9b		
10 Taxable refunds, credits, or offsets of state and local income taxes (see page 20)	10		
11 Alimony received	11		
12 Business income or (loss). Attach Schedule C or C-EZ	12	2,400	00
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/>	13		
14 Other gains or (losses). Attach Form 4797	14		
15a IRA distributions	15a		
b Taxable amount (see page 21)	15b		
16a Pensions and annuities	16a		
b Taxable amount (see page 22)	16b		
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17		
18 Farm income or (loss). Attach Schedule F	18		
19 Unemployment compensation	19		
20a Social security benefits	20a		
b Taxable amount (see page 24)	20b		
21 Other income. List type and amount (see page 24)	21		
22 Add the amounts in the far right column for lines 7 through 21. This is your total income ▶	22	28,400	00

**Adjusted Gross Income**

23 Archer MSA deduction. Attach Form 8853	23		
24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25 Health savings account deduction. Attach Form 8889	25		
26 Moving expenses. Attach Form 3903	26		
27 One-half of self-employment tax. Attach Schedule SE	27	170	00
28 Self-employed SEP, SIMPLE, and qualified plans	28		
29 Self-employed health insurance deduction (see page 26)	29		
30 Penalty on early withdrawal of savings	30		
31a Alimony paid b Recipient's SSN ▶	31a		
32 IRA deduction (see page 27)	32	600	00
33 Student loan interest deduction (see page 30)	33		
34 Jury duty pay you gave to your employer	34		
35 Domestic production activities deduction. Attach Form 8903	35		
36 Add lines 23 through 31a and 32 through 35	36	770	00
37 Subtract line 36 from line 22. This is your adjusted gross income ▶	37	27,630	00

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 83.

Cat. No. 11320B

Form **1040** (2008)

**Tax and Credits****Standard Deduction for—**

• People who checked any box on line 39a, 39b, or 39c or who can be claimed as a dependent, see page 31.

• All others:  
Single or Married filing separately, \$5,450

Married filing jointly or Qualifying widow(er), \$10,900

Head of household, \$8,000

**Other Taxes****Payments**

If you have a qualifying child, attach Schedule EIC.

**Refund**

Direct deposit? See page 59 and fill in 73b, 73c, and 73d, or Form 8888.

**Amount You Owe****Third Party Designee****Sign Here**

Joint return? See page 13. Keep a copy for your records.

**Paid Preparer's Use Only**

<b>38</b>	Amount from line 37 (adjusted gross income)	<b>38</b>	<b>27,630</b>	<b>00</b>
<b>39a</b>	Check <input type="checkbox"/> You were born before January 2, 1944, <input type="checkbox"/> Blind. <input type="checkbox"/> Spouse was born before January 2, 1944, <input type="checkbox"/> Blind. Total boxes checked <b>▶ 39a</b>			
<b>b</b>	If your spouse itemizes on a separate return or you were a dual-status alien, see page 31 and check here <b>▶ 39b</b>			
<b>c</b>	If you claim the standard deduction and are deducting real estate taxes, check here (see page 31) <b>▶ 39c</b>			
<b>40</b>	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	<b>40</b>	<b>8,000</b>	<b>00</b>
<b>41</b>	Subtract line 40 from line 38	<b>41</b>	<b>19,630</b>	<b>00</b>
<b>42</b>	If line 38 is \$119,975 or less, multiply \$3,500 by the total number of exemptions claimed on line 6d. If line 38 is over \$119,975, see the worksheet on page 33	<b>42</b>	<b>10,500</b>	<b>00</b>
<b>43</b>	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	<b>43</b>	<b>9,130</b>	<b>00</b>
<b>44</b>	Tax (see page 33). Check if any tax is from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972	<b>44</b>	<b>913</b>	<b>00</b>
<b>45</b>	Alternative minimum tax (see page 36). Attach Form 6251	<b>45</b>		
<b>46</b>	Add lines 44 and 45	<b>46</b>	<b>913</b>	<b>00</b>
<b>47</b>	Credit for child and dependent care expenses. Attach Form 2441	<b>47</b>	<b>420</b>	<b>00</b>
<b>48</b>	Credit for the elderly or the disabled. Attach Schedule R	<b>48</b>		
<b>49</b>	Education credits. Attach Form 8863	<b>49</b>	<b>86</b>	<b>00</b>
<b>50</b>	Foreign tax credit. Attach Form 1116 if required	<b>50</b>		
<b>51</b>	Child tax credit (see page 39). Attach Form 8901 if required	<b>51</b>	<b>247</b>	<b>00</b>
<b>52</b>	Retirement savings contributions credit. Attach Form 8880	<b>52</b>	<b>160</b>	<b>00</b>
<b>53</b>	Credits from Form: <b>a</b> <input type="checkbox"/> 8396 <b>b</b> <input type="checkbox"/> 5695 <b>c</b> <input type="checkbox"/> 8839	<b>53</b>		
<b>54</b>	Other credits from Form: <b>a</b> <input type="checkbox"/> 3800 <b>b</b> <input type="checkbox"/> 8801 <b>c</b> <input type="checkbox"/>	<b>54</b>		
<b>55</b>	Add lines 47 through 54. These are your total credits	<b>55</b>	<b>913</b>	<b>00</b>
<b>56</b>	Subtract line 55 from line 46. If line 55 is more than line 46, enter -0-	<b>56</b>	<b>0</b>	<b>00</b>
<b>57</b>	Self-employment tax. Attach Schedule SE	<b>57</b>	<b>339</b>	<b>00</b>
<b>58</b>	Unreported social security and Medicare tax from Form: <b>a</b> <input type="checkbox"/> 4137 <b>b</b> <input type="checkbox"/> 8919	<b>58</b>		
<b>59</b>	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	<b>59</b>		
<b>60</b>	Additional taxes: <b>a</b> <input type="checkbox"/> AEIC payments <b>b</b> <input type="checkbox"/> Household employment taxes. Attach Schedule H	<b>60</b>		
<b>61</b>	Add lines 56 through 60. This is your total tax	<b>61</b>	<b>339</b>	<b>00</b>
<b>62</b>	Federal income tax withheld from Forms W-2 and 1099	<b>62</b>	<b>1,240</b>	<b>00</b>
<b>63</b>	2008 estimated tax payments and amount applied from 2007 return	<b>63</b>		
<b>64a</b>	Earned income credit (EIC)	<b>64a</b>	<b>2,195</b>	<b>00</b>
<b>b</b>	Nontaxable combat pay election <b>64b</b>			
<b>65</b>	Excess social security and tier 1 RRTA tax withheld (see page 59)	<b>65</b>		
<b>66</b>	Additional child tax credit. Attach Form 8812	<b>66</b>	<b>1,753</b>	<b>00</b>
<b>67</b>	Amount paid with request for extension to file (see page 59)	<b>67</b>		
<b>68</b>	Credits from Form: <b>a</b> <input type="checkbox"/> 2439 <b>b</b> <input type="checkbox"/> 4136 <b>c</b> <input type="checkbox"/> 8801 <b>d</b> <input type="checkbox"/> 8885	<b>68</b>		
<b>69</b>	First-time homebuyer credit. Attach Form 5405	<b>69</b>		
<b>70</b>	Recovery rebate credit (see worksheet on page xx)	<b>70</b>	<b>300</b>	<b>00</b>
<b>71</b>	Add lines 62 through 70. These are your total payments	<b>71</b>	<b>5,488</b>	<b>00</b>
<b>72</b>	If line 71 is more than line 61, subtract line 61 from line 71. This is the amount you overpaid	<b>72</b>	<b>5,149</b>	<b>00</b>
<b>73a</b>	Amount of line 72 you want refunded to you. If Form 8888 is attached, check here <input checked="" type="checkbox"/>	<b>73a</b>	<b>5,149</b>	<b>00</b>
<b>b</b>	Routing number <input type="text"/>	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
<b>d</b>	Account number <input type="text"/>			
<b>74</b>	Amount of line 72 you want applied to your 2009 estimated tax <b>▶ 74</b>	<b>74</b>		
<b>75</b>	Amount you owe. Subtract line 71 from line 61. For details on how to pay, see page 60 <b>▶ 75</b>	<b>75</b>		
<b>76</b>	Estimated tax penalty (see page 61) <b>▶ 76</b>	<b>76</b>		
Do you want to allow another person to discuss this return with the IRS (see page 61)? <input type="checkbox"/> Yes. Complete the following. <input checked="" type="checkbox"/> No				
Designee's name <b>▶</b>	Phone no. <b>▶</b> ( )	Personal identification number (PIN) <b>▶</b>	<input type="text"/>	
Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.				
Your signature	Date	Your occupation	Daytime phone number	
		<b>Sales</b>	<b>( 303 ) 555-5555</b>	
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation		
Preparer's signature <b>▶</b>	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN	
Firm's name (or yours if self-employed), address, and ZIP code <b>▶</b>	<b>Volunteer Site</b>		<b>XXXXXXXXXX</b>	
	EIN			
	Phone no. ( )			





**SCHEDULE C-EZ  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

Name of proprietor

**Vanessa L. Franklin**

**Net Profit From Business**  
(Sole Proprietorship)

- Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.  
► Attach to Form 1040, 1040NR, or 1041. ► See instructions on back.

OMB No. 1545-0074

**2008**

Attachment  
Sequence No. **09A**

Social security number (SSN)

**111 : 11 : 5555**

**Part I** General Information

**You May Use  
Schedule C-EZ  
Instead of  
Schedule C  
Only If You:**

- Had business expenses of \$5,000 or less.
- Use the cash method of accounting.
- Did not have an inventory at any time during the year.
- Did not have a net loss from your business.
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee.

**And You:**

- Had no employees during the year.
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, on page C-4 to find out if you must file.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

**A** Principal business or profession, including product or service

**Cosmetic Sales**

**B** Enter code from pages C-8, 9, & 10

► **4 5 4 3 9 0**

**C** Business name. If no separate business name, leave blank.

**D** Employer ID number (EIN), if any

**E** Business address (including suite or room no.). Address not required if same as on page 1 of your tax return.

City, town or post office, state, and ZIP code

**Part II** Figure Your Net Profit

**1 Gross receipts. Caution.** See the instructions for Schedule C, line 1, on page C-3 and check the box if:

- This income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, or
- You are a member of a qualified joint venture reporting only rental real estate income not subject to self-employment tax . . . . . ☐

**1** **2,990** **00**

**2 Total expenses** (see instructions on page 2). If more than \$5,000, you **must** use Schedule C

**2** **590** **00**

**3 Net profit.** Subtract line 2 from line 1. If less than zero, you **must** use Schedule C. Enter on both **Form 1040, line 12**, and **Schedule SE, line 2**, or on **Form 1040NR, line 13**. (If you checked the box on line 1, **do not** report the amount from line 3 on Schedule SE, line 2.) Estates and trusts, enter on **Form 1041, line 3** . . . . .

**3** **2,400** **00**

**Part III** Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

**4** When did you place your vehicle in service for business purposes? (month, day, year) ► . . . . .

**5** Of the total number of miles you drove your vehicle during 2008, enter the number of miles you used your vehicle for:

**a** Business . . . . . **b** Commuting (see instructions) . . . . . **c** Other . . . . .

**6** Was your vehicle available for personal use during off-duty hours? . . . . . ☐ **Yes** ☐ **No**

**7** Do you (or your spouse) have another vehicle available for personal use? . . . . . ☐ **Yes** ☐ **No**

**8a** Do you have evidence to support your deduction? . . . . . ☐ **Yes** ☐ **No**

**b** If "Yes," is the evidence written? . . . . . ☐ **Yes** ☐ **No**

For Paperwork Reduction Act Notice, see page 2.

Cat. No. 14374D

Schedule C-EZ (Form 1040) 2008

**SCHEDULE SE**  
**(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Self-Employment Tax**

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule SE (Form 1040).**

OMB No. 1545-0074

**2008**

Attachment  
Sequence No. **17**

Name of person with **self-employment** income (as shown on Form 1040)

**Vanessa L. Franklin**

Social security number of person  
with **self-employment** income ▶

**111 11 5555**

**Who Must File Schedule SE**

You must file Schedule SE if:

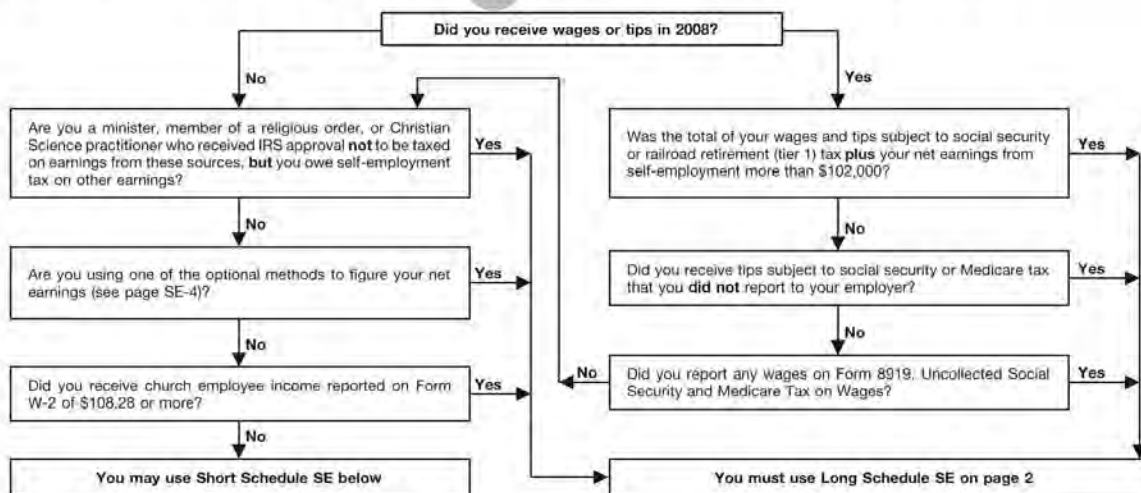
- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more, **or**
- You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order **is not** church employee income (see page SE-1).

**Note.** Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE (see page SE-4).

**Exception.** If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 57.

**May I Use Short Schedule SE or Must I Use Long Schedule SE?**

**Note.** Use this flowchart **only** if you must file Schedule SE. If unsure, see *Who Must File Schedule SE*, above.



**Section A—Short Schedule SE. Caution.** Read above to see if you can use Short Schedule SE.

1	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A . . . . .	1		
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see page SE-1 for types of income to report on this line. See page SE-3 for other income to report . . . . .	2	2,400	00
3	Combine lines 1 and 2 . . . . .	3	2,400	00
4	<b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax . . . . . ▶	4	2,216	00
5	<b>Self-employment tax.</b> If the amount on line 4 is: • \$102,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 57.</b> • More than \$102,000, multiply line 4 by 2.9% (.029). Then, add \$12,648 to the result. Enter the total here and on <b>Form 1040, line 57</b> . . . . .	5	339	00
6	<b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 27</b> . . . . .	6	170	00

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 2008



Form **2441****Child and Dependent Care Expenses**

OMB No. 1545-0074

**2008**Attachment  
Sequence No. **21**Department of the Treasury  
Internal Revenue Service (99)

▶ Attach to Form 1040 or Form 1040NR.

▶ See separate instructions.

Name(s) shown on return

**Vanessa L. Franklin**

Your social security number

**111 11 5555****Part I** **Persons or Organizations Who Provided the Care—You must complete this part.**  
(If you have more than two care providers, see the instructions.)

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
	<b>Koala Bears Day Care</b>	<b>456 Chapman Ave. Denver, CO 80202</b>	<b>82-1111111</b>	<b>1,500 00</b>

Did you receive  
dependent care benefits?

No

Complete only Part II below.

Yes

Complete Part III on the back next.

**Caution.** If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 61, or Form 1040NR, line 56.**Part II** **Credit for Child and Dependent Care Expenses****2** Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

(a) Qualifying person's name		(b) Qualifying person's social security number		(c) Qualified expenses you incurred and paid in 2008 for the person listed in column (a)
First	Last			
<b>Zoe</b>	<b>Franklin</b>	<b>111</b>	<b>11 7777</b>	<b>1,500 00</b>

**3** Add the amounts in column (c) of line 2. **Do not** enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 35**3 1,500 00****4** Enter your **earned income**. See instructions**4 28,230 00****5** If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4**5 28,230 00****6** Enter the **smallest** of line 3, 4, or 5**6 1,500 00****7** Enter the amount from Form 1040, line 38, or Form 1040NR, line 36**7 27,630 00****8** Enter on line 8 the decimal amount shown below that applies to the amount on line 7

If line 7 is:

If line 7 is:

Over	But not over	Decimal amount is
\$0—15,000		.35
15,000—17,000		.34
17,000—19,000		.33
19,000—21,000		.32
21,000—23,000		.31
23,000—25,000		.30
25,000—27,000		.29
27,000—29,000		.28

Over	But not over	Decimal amount is
\$29,000—31,000		.27
31,000—33,000		.26
33,000—35,000		.25
35,000—37,000		.24
37,000—39,000		.23
39,000—41,000		.22
41,000—43,000		.21
43,000—No limit		.20

**8 × .28****9** Multiply line 6 by the decimal amount on line 8. If you paid 2007 expenses in 2008, see the instructions**9 420 00****10** Enter the amount from Form 1040, line 44, or Form 1040NR, line 41**10 913 00****11** Enter the amount from Form 6251, line 31**11 0 00****12** Subtract line 11 from line 10. If zero or less, **stop**. You cannot take the credit**12 913 00****13** **Credit for child and dependent care expenses.** Enter the **smaller** of line 9 or line 12 here and on Form 1040, line 47, or Form 1040NR, line 44**13 420 00**

For Paperwork Reduction Act Notice, see page 4 of the instructions.

Cat. No. 11862M

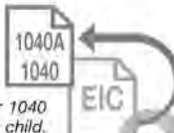
Form **2441** (2008)

**SCHEDULE EIC**  
**(Form 1040A or 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Earned Income Credit**  
**Qualifying Child Information**

Complete and attach to Form 1040A or 1040  
only if you have a qualifying child.



OMB No. 1545-0074

**2008**

Attachment  
Sequence No. **43**

Name(s) shown on return

**Vanessa L Franklin**

Your social security number

**111 11 5555**

- Before you begin:**
- See the instructions for Form 1040A, line 40, or Form 1040, line 65, to make sure that (a) you can take the EIC, and (b) you have a qualifying child.
  - Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.

**Qualifying Child Information**

**Child 1**

**Child 2**

	First name	Last name	First name	Last name
<b>1 Child's name</b> If you have more than two qualifying children, you only have to list two to get the maximum credit.	<b>Zoe Franklin</b>		<b>Zachary Franklin</b>	
<b>2 Child's SSN</b> The child must have an SSN as defined on page 41 of the Form 1040A instructions or page 47 of the Form 1040 instructions unless the child was born and died in 2008. If your child was born and died in 2008 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.	<b>111</b>	<b>11 7777</b>	<b>111</b>	<b>11 9999</b>
<b>3 Child's year of birth</b>	Year <b>2 0 0 3</b> <i>If born after 1989, skip lines 4a and 4b; go to line 5.</i>		Year <b>1 9 9 9</b> <i>If born after 1989, skip lines 4a and 4b; go to line 5.</i>	
<b>4 If the child was born before 1990—</b>				
<b>a</b> Was the child under age 24 at the end of 2008 and a student?	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 5.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue.</i>	<input type="checkbox"/> <b>Yes.</b> <i>Go to line 5.</i>	<input type="checkbox"/> <b>No.</b> <i>Continue.</i>
<b>b</b> Was the child permanently and totally disabled during any part of 2008?	<input type="checkbox"/> <b>Yes.</b> <i>Continue.</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.	<input type="checkbox"/> <b>Yes.</b> <i>Continue.</i>	<input type="checkbox"/> <b>No.</b> The child is not a qualifying child.
<b>5 Child's relationship to you</b> (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)	<b>daughter</b>		<b>son</b>	
<b>6 Number of months child lived with you in the United States during 2008</b> • If the child lived with you for more than half of 2008 but less than 7 months, enter "7." • If the child was born or died in 2008 and your home was the child's home for the entire time he or she was alive during 2008, enter "12."	<b>12</b> months <i>Do not enter more than 12 months.</i>		<b>12</b> months <i>Do not enter more than 12 months.</i>	



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2008, and (b) is a U.S. citizen or resident alien. For more details, see the instructions for line 41 of Form 1040A or line 67 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2008



Form **8812****Additional Child Tax Credit**Department of the Treasury  
Internal Revenue Service (99)

Complete and attach to Form 1040, Form 1040A, or Form 1040NR.

1040  
1040A  
1040NR

OMB No. 1545-0074

**2008**Attachment  
Sequence No. **47**

Name(s) shown on return

**Vanessa L. Franklin**

Your social security number

**111 11 5555****Part I All Filers**

- 1 Enter the amount from line 1 of your Child Tax Credit Worksheet on page XX of the Form 1040 instructions, page XX of the Form 1040A instructions, or page XX of the Form 1040NR instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page X of the publication . . . . . **1 2,000 00**
- 2 Enter the amount from Form 1040, line 51, Form 1040A, line 32, or Form 1040NR, line 46 . . . . . **2 247 00**
- 3 Subtract line 2 from line 1. If zero, stop; you cannot take this credit . . . . . **3 1,753 00**
- 4a Enter your total earned income (see instructions on back) . . . . . **4a 28,230 00**
- b Nontaxable combat pay (see instructions on back) . . . . . **4b**
- 5 Is the amount on line 4a more than \$12,050?  
☐ No. Leave line 5 blank and enter -0- on line 6.  
☒ Yes. Subtract \$12,050 from the amount on line 4a. Enter the result . . . . . **5 16,180 00**
- 6 Multiply the amount on line 5 by 15% (.15) and enter the result . . . . . **6 2,427 00**  
Next, Do you have three or more qualifying children?  
☒ No. If line 6 is zero, stop; you cannot take this credit. Otherwise, skip Part II and enter the smaller of line 3 or line 6 on line 13.  
☐ Yes. If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.

**Part II Certain Filers Who Have Three or More Qualifying Children**

- 7 Withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see instructions on back . . . . . **7**
- 8 **1040 filers:** Enter the total of the amounts from Form 1040, lines 27 and 58, plus any taxes that you identified using code "UT" and entered on the dotted line next to line 62.  
**1040A filers:** Enter -0-.  
**1040NR filers:** Enter the total of the amounts from Form 1040NR, line 53, plus any taxes that you identified using code "UT" and entered on the dotted line next to line 57. . . . . **8**
- 9 Add lines 7 and 8 . . . . . **9**
- 10 **1040 filers:** Enter the total of the amounts from Form 1040, lines 65 and 66.  
**1040A filers:** Enter the total of the amount from Form 1040A, line 40, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 44 (see instructions on back).  
**1040NR filers:** Enter the amount from Form 1040NR, line 60. . . . . **10**
- 11 Subtract line 10 from line 9. If zero or less, enter -0- . . . . . **11**
- 12 Enter the larger of line 6 or line 11 . . . . . **12**  
Next, enter the smaller of line 3 or line 12 on line 13.

**Part III Additional Child Tax Credit**

- 13 This is your additional child tax credit . . . . . **13 1,753 00**

1040  
1040A  
1040NREnter this amount on  
Form 1040, line 67,  
Form 1040A, line 41, or  
Form 1040NR, line 61.

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 10644E

Form **8812** (2008)

**Education Credits**  
**(Hope and Lifetime Learning Credits)**  
▶ See instructions to find out if you are eligible to take the credits.  
▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-0074  
**2008**  
Attachment  
Sequence No. **50**

Name(s) shown on return

**Vanessa L. Franklin**

Your social security number  
**111 11 5555**

**Caution:** • You **cannot** take the Hope credit and the lifetime learning credit for the **same** student in the same year.

**Part I Hope Credit.** **Caution:** You **cannot** take the Hope credit for more than **2** tax years for the **same** student.

1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (see instructions). <b>Do not</b> enter more than \$2,400 for each student.	(d) Enter the <b>smaller</b> of the amount in column (c) or \$1,200	(e) Add column (c) and column (d)	(f) Enter one-half of the amount in column (e)
2	<b>Tentative Hope credit.</b> Add the amounts on line 1, column (f). If you are taking the lifetime learning credit for another student, go to Part II; otherwise, go to Part III.					<b>2</b>

**Part II Lifetime Learning Credit**

3	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (see instructions)
	<b>Vanessa L. Franklin</b>	<b>111 11 5555</b>	<b>430 00</b>
4	Add the amounts on line 3, column (c), and enter the total.		<b>430 00</b>
5	Enter the <b>smaller</b> of line 4 or \$10,000		<b>430 00</b>
6	<b>Tentative lifetime learning credit.</b> Multiply line 5 by 20% (.20) and go to Part III.		<b>86 00</b>

**Part III Allowable Education Credits**

7	Tentative education credits. Add lines 2 and 6	<b>86 00</b>
8	Enter: \$116,000 if married filing jointly; \$58,000 if single, head of household, or qualifying widow(er)	<b>58,000 00</b>
9	Enter the amount from Form 1040, line 38,* or Form 1040A, line 22	<b>27,630 00</b>
10	Subtract line 9 from line 8. If zero or less, <b>stop</b> ; you cannot take any education credits	<b>30,370 00</b>
11	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	<b>10,000 00</b>
12	If line 10 is equal to or more than line 11, enter the amount from line 7 on line 13 and go to line 14. If line 10 is less than line 11, divide line 10 by line 11. Enter the result as a decimal (rounded to at least three places)	<b>12</b>
13	Multiply line 7 by line 12	<b>86 00</b>
14	Enter the amount from Form 1040, line 44, or Form 1040A, line 28 (minus any alternative minimum tax included on Form 1040A, line 28)	<b>913 00</b>
15	Enter the total, if any, of your credits from Form 1040, lines 47 and 48, or Form 1040A, lines 29 and 30	<b>420 00</b>
16	1040 filers: Enter the amount from Form 6251, line 31 (see instructions) 1040A filers: Enter the amount, if any, from the Alternative Minimum Tax Worksheet, line 20 (see instructions)	<b>16</b>
17	Add lines 15 and 16	<b>420 00</b>
18	Subtract line 17 from line 14. If zero or less, <b>stop</b> . You cannot take any education credits	<b>493 00</b>
19	<b>Education credits.</b> Enter the smaller of line 13 or line 18 here and on Form 1040, line 49, or Form 1040A, line 31	<b>86 00</b>

\* If you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from Puerto Rico, see Pub. 970 for the amount to enter.

For Paperwork Reduction Act Notice, see page 3.

Cat. No. 25379M

Form **8863** (2008)



Form **8880**Department of the Treasury  
Internal Revenue Service**Credit for Qualified Retirement Savings Contributions**

▶ Attach to Form 1040, Form 1040A, or Form 1040NR.

▶ See instructions on back.

OMB No. 1545-0074

**2008**Attachment  
Sequence No. **55**

Name(s) shown on return

**Vanessa Franklin**

Your social security number

**111 : 11 : 5555**You **cannot** take this credit if **either** of the following applies.

- The amount on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36 is more than \$26,500 (\$39,750 if head of household; \$53,000 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1991, **(b)** is claimed as a dependent on someone else's 2008 tax return, or **(c)** was a **student** (see instructions).

	(a) You	(b) Your spouse
1 Traditional and Roth IRA contributions for 2008. <b>Do not</b> include rollover contributions . . . . .	<b>1</b> 600 00	
2 Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18)(D) plan contributions for 2008 (see instructions) . . . . .	<b>2</b> 1000 00	
3 Add lines 1 and 2 . . . . .	<b>3</b> 1600 00	
4 Certain distributions received <b>after</b> 2005 and <b>before</b> the due date (including extensions) of your 2008 tax return (see instructions). If married filing jointly, include <b>both</b> spouses' amounts in <b>both</b> columns. See instructions for an exception . . . . .	<b>4</b> 0 00	
5 Subtract line 4 from line 3. If zero or less, enter -0- . . . . .	<b>5</b> 1600 00	
6 In each column, enter the <b>smaller</b> of line 5 or \$2,000 . . . . .	<b>6</b> 1600 00	
7 Add the amounts on line 6. If zero, <b>stop</b> ; you cannot take this credit . . . . .		<b>7</b> 1600 00
8 Enter the amount from Form 1040, line 38*; Form 1040A, line 22; or Form 1040NR, line 36 . . . . .	<b>8</b> 27630 00	
9 Enter the applicable decimal amount shown below:		

If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
Enter on line 9—				
---	\$16,000	.5	.5	.5
\$16,000	\$17,250	.5	.5	.2
\$17,250	\$24,000	.5	.5	.1
\$24,000	\$25,875	.5	.2	.1
\$25,875	\$26,500	.5	.1	.1
\$26,500	\$32,000	.5	.1	.0
\$32,000	\$34,500	.2	.1	.0
\$34,500	\$39,750	.1	.1	.0
\$39,750	\$53,000	.1	.0	.0
\$53,000	---	.0	.0	.0

**Note:** If line 9 is zero, **stop**; you cannot take this credit.

10 Multiply line 7 by line 9 . . . . .	<b>10</b> 160 00
11 Enter the amount from Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 43 . . . . .	<b>11</b> 913 00
12 <b>1040 filers:</b> Enter the total of your credits from lines 47 through 50, line 12 of the Line 11 Worksheet in Pub. 972 (see instructions), plus the amounts, if any, from line 13 of Form 8396, line 20 of Form 5695, and line 7 of Form 8859.	<b>12</b> 506 00
<b>1040A filers:</b> Enter the total of your credits from lines 29 through 32.	
<b>1040NR filers:</b> Enter the total of your credits from lines 44 and 45, line 12 of the Line 11 Worksheet in Pub. 972 (see instructions), plus the amounts, if any, from line 13 of Form 8396, line 20 of Form 5695, and line 7 of Form 8859.	
13 Subtract line 12 from line 11. If zero, <b>stop</b> ; you cannot take this credit . . . . .	<b>13</b> 407 00
14 <b>Credit for qualified retirement savings contributions.</b> Enter the <b>smaller</b> of line 10 or line 13 here and on Form 1040, line 52; Form 1040A, line 33; or Form 1040NR, line 47 . . . . .	<b>14</b> 160 00

\*See Pub. 590 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 33394D

Form **8880** (2008)

Form **8888****Direct Deposit of Refund to More Than One Account**

OMB No. 1545-0074

Department of the Treasury  
Internal Revenue Service▶ See instructions below and on back.  
▶ Attach to Form 1040, Form 1040A, Form 1040EZ,  
Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.**2008**Attachment  
Sequence No. **56**

Name(s) shown on return

**Vanessa L. Franklin**

Your social security number

**111 11 5555****1a** Amount to be deposited in first account**1a** **1,000 00****b** Routing number **3 2 5 2 7 2 0 2 1** ▶ ☐ Checking ☒ Savings**d** Account number **1 1 1 1****2a** Amount to be deposited in second account**2a** **4,149 00****b** Routing number **1 2 5 2 0 0 6 9 1** ▶ ☒ Checking ☐ Savings**d** Account number **9 9 9 9 9 9****3a** Amount to be deposited in third account**3a****b** Routing number  ▶ ☐ Checking ☐ Savings**d** Account number **4 Total amount to be directly deposited.** Add lines 1a, 2a, and 3a. The total must equal the amount shown on Form 1040, line 75a; Form 1040A, line 46a; Form 1040EZ, line 13a; Form 1040NR, line 71a; Form 1040NR-EZ, line 23a; Form 1040-SS, line 12a; or Form 1040-PR, line 12a.**4** **5,149 00****General Instructions****Purpose of Form**

Use Form 8888 if you want us to directly deposit your tax refund to either two or three of your accounts at a bank or other financial institution (such as a mutual fund, brokerage firm, or credit union). If you file Form 8888, you cannot choose to get any part of your refund as a check. You cannot request a deposit of your refund to an account that is not in your name (such as your tax preparer's own account). An account can be a checking, savings, or other account such as an individual retirement arrangement (IRA) (see page 2 for more information on IRAs), health savings account (HSA), Archer MSA, Coverdell education savings account (ESA), or Treasury Direct online account. You cannot have your refund deposited into more than one account if you file Form 8379, Injured Spouse Allocation.

**Note.** If you want your refund deposited to only one account, do not complete this form. Instead, request direct deposit on your tax return.

**Treasury Direct.** You can request a deposit of your refund to a Treasury Direct online

account to buy U.S. Treasury securities and electronic savings bonds. For more information, go to [www.TreasuryDirect.gov](http://www.TreasuryDirect.gov).



**CAUTION** Do not file a Form 8888 on which you have crossed out or whited out any numbers. If you do, the IRS will reject your direct deposit and send you a check.

**Why Use Direct Deposit?**

- You get your refund faster.
- Payment is more secure. There is no check that can get lost or stolen.
- It is more convenient. You do not have to make a trip to the bank.
- It saves tax dollars because it costs the government less.



**CAUTION** The IRS is not responsible for a lost refund if you enter the wrong account information. You should check with your financial institution to get the correct routing and account numbers and make sure your deposit will be accepted. Do not use the routing number on a deposit slip if it is different from the routing number on your checks.

**Specific Instructions**

If you file a joint return and you complete and attach Form 8888, your spouse may get at least part of the refund. You should review who owns the account where the refund is being sent.



**CAUTION** Some financial institutions will not allow a joint refund to be deposited to an individual account. If the direct deposit is rejected, a check will be sent instead. The IRS is not responsible if a financial institution rejects a direct deposit.

**Lines 1a, 2a, and 3a**

Enter the portion of your refund you want directly deposited to each account. Each deposit must be at least \$1. The amount of your refund can be found on Form 1040, line 75a; Form 1040A, line 46a; Form 1040EZ, line 13a; Form 1040NR, line 71a; Form 1040NR-EZ, line 23a; Form 1040-SS, line 12a; or Form 1040-PR, line 12a. The total of lines 1a, 2a, and 3a must equal the total amount of your refund.

**Lines 1b, 2b, and 3b**

The routing number must be nine digits. The first two digits must be 01 through 12 or 21 through 32. Otherwise, the direct deposit will be rejected and a check sent instead. On the sample check, the routing number is 250250025. Jeffrey and Suzanne Maple would use that routing number unless their financial institution instructed them to use a different routing number for direct deposits.

Ask your financial institution for the correct routing number to enter if:

- Your deposit is to a savings account that does not allow you to write checks, or
- Your checks state they are payable through a financial institution different from the one at which you have your account.

**Sample Check**

**JEFFREY MAPLE  
SUZANNE MAPLE**  
123 Pear Lane  
Anyplace, VA 20000

PAY TO THE  
ORDER OF \_\_\_\_\_ \$ **1234**

ANYPLACE BANK  
Anyplace, VA 20000

For **Routing number** **250250025** **Account number** **202020186** **1234**

**Do not include the check number.**

**Note.** The routing and account numbers may be in different places on your check.

For Paperwork Reduction Act Notice, see back.

Cat. No. 21858A

Form **8888** (2008)



The "Retirement plan" box in box 13 of your Form W-2 should be checked if you were covered by a plan at work even if you were not vested in the plan. You are also covered by a plan if you were self-employed and had a SEP, SIMPLE, or qualified retirement plan.

If you were covered by a retirement plan and you file Form 2555, 2555-EZ, or 8815,

or you exclude employer-provided adoption benefits, see Pub. 590 to figure the amount, if any, of your IRA deduction.

**Married persons filing separately.** If you were not covered by a retirement plan but your spouse was, you are considered covered by a plan unless you lived apart from your spouse for all of 2008.



You may be able to take the retirement savings contributions credit. See the instructions for line 52 on page 41.

## IRA Deduction Worksheet—Line 32

Keep for Your Records



If you were age 70½ or older at the end of 2008, you cannot deduct any contributions made to your traditional IRA or treat them as nondeductible contributions. **Do not** complete this worksheet for anyone age 70½ or older at the end of 2008. If you are married filing jointly and only one spouse was under age 70½ at the end of 2008, complete this worksheet only for that spouse.

### Before you begin:

- ✓ Be sure you have read the list on page 27. You may not be eligible to use this worksheet.
- ✓ Figure any amount on Form 1040, line 34, and any write-in adjustments to be entered on the dotted line next to line 36 (see the instructions for line 36 on page 31).

		Your IRA	Spouse's IRA
1a.	Were you covered by a retirement plan (see above)?	1a. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
b.	If married filing jointly, was your spouse covered by a retirement plan?		1b. <input type="checkbox"/> Yes <input type="checkbox"/> No
<p>Next, if you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6, enter the applicable amount below on line 7a (and line 7b if applicable), and go to line 8.</p> <ul style="list-style-type: none"> <li>\$5,000, if under age 50 at the end of 2008.</li> <li>\$6,000, if age 50 or older but under age 70½ at the end of 2008.</li> </ul> <p>Otherwise, go to line 2.</p>			
2.	Enter the amount shown below that applies to you.		
<ul style="list-style-type: none"> <li>Single, head of household, or married filing separately and you lived apart from your spouse for all of 2008, enter \$63,000</li> <li>Qualifying widow(er), enter \$105,000</li> <li>Married filing jointly, enter \$105,000 in both columns. But if you checked "No" on either line 1a or 1b, enter \$169,000 for the person who was not covered by a plan</li> <li>Married filing separately and you lived with your spouse at any time in 2008, enter \$10,000</li> </ul>		2a. 63,000.00	2b.
3.	Enter the amount from Form 1040, line 22	3. 28,400.00	
4.	Enter the total of the amounts from Form 1040, lines 23 through 31a, line 34, and any write-in adjustments you entered on the dotted line next to line 36	4. 170.00	
5.	Subtract line 4 from line 3. If married filing jointly, enter the result in both columns	5a. 28,230.00	5b.
6.	Is the amount on line 5 less than the amount on line 2?		
<p><input type="checkbox"/> No. <b>STOP</b> None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.</p> <p><input checked="" type="checkbox"/> Yes. Subtract line 5 from line 2 in each column. Follow the instruction below that applies to you.</p> <ul style="list-style-type: none"> <li>If single, head of household, or married filing separately, and the result is \$10,000 or more, enter the applicable amount below on line 7 for that column and go to line 8. <ul style="list-style-type: none"> <li>i. \$5,000, if under age 50 at the end of 2008.</li> <li>ii. \$6,000, if age 50 or older but under age 70½ at the end of 2008.</li> </ul> <p>Otherwise, go to line 7.</p> </li> <li>If married filing jointly or qualifying widow(er), and the result is \$20,000 or more (\$10,000 or more in the column for the IRA of a person who was not covered by a retirement plan), enter the applicable amount below on line 7 for that column and go to line 8. <ul style="list-style-type: none"> <li>i. \$5,000, if under age 50 at the end of 2008.</li> <li>ii. \$6,000 if age 50 or older but under age 70½ at the end of 2008.</li> </ul> <p>Otherwise, go to line 7.</p> </li> </ul>			
		6a. 34,770.00	6b.



**IRA Deduction Worksheet—Line 32 (continued)**

	Your IRA	Spouse's IRA
<p>7. Multiply lines 6a and 6b by the percentage below that applies to you. If the result is not a multiple of \$10, increase it to the next multiple of \$10 (for example, increase \$490.30 to \$500). If the result is \$200 or more, enter the result. But if it is less than \$200, enter \$200.</p> <ul style="list-style-type: none"> <li>• Single, head of household, or married filing separately, multiply by 50% (.50) (or by 60% (.60) in the column for the IRA of a person who is age 50 or older at the end of 2008)</li> <li>• Married filing jointly or qualifying widow(er), multiply by 25% (.25) (or by 30% (.30) in the column for the IRA of a person who is age 50 or older at the end of 2008). But if you checked "No" on either line 1a or 1b, then in the column for the IRA of the person who was not covered by a retirement plan, multiply by 50% (.50) (or by 60% (.60) if age 50 or older at the end of 2008)</li> </ul>	7a. <b>5,000.00</b>	7b.
<p>8. Enter the total of your (and your spouse's if filing jointly):</p> <ul style="list-style-type: none"> <li>• Wages, salaries, tips, etc. Generally, this is the amount reported in box 1 of Form W-2. See page 27 for exceptions</li> <li>• Alimony and separate maintenance payments reported on Form 1040, line 11</li> <li>• Nontaxable combat pay. This amount should be reported in box 12 of Form W-2 with code Q</li> </ul>	8. <b>26,000.00</b>	
<p>9. Enter the earned income you (and your spouse if filing jointly) received as a self-employed individual or a partner. Generally, this is your (and your spouse's if filing jointly) net earnings from self-employment if your personal services were a material income-producing factor, minus any deductions on Form 1040, lines 27 and 28. If zero or less, enter -0-. For more details, see Pub. 590</p>	9. <b>2,230.00</b>	
<p>10. Add lines 8 and 9</p>	10. <b>28,230.00</b>	
<p><b>CAUTION</b> If married filing jointly and line 10 is less than \$10,000 (\$11,000 if one spouse is age 50 or older at the end of 2008; \$12,000 if both spouses are age 50 or older at the end of 2008), <b>stop here</b> and see Pub. 590 to figure your IRA deduction.</p>		
<p>11. Enter traditional IRA contributions made, or that will be made by April 15, 2009, for 2008 to your IRA on line 11a and to your spouse's IRA on line 11b</p>	11a. <b>600.00</b>	11b.
<p>12. On line 12a, enter the <b>smallest</b> of line 7a, 10, or 11a. On line 12b, enter the <b>smallest</b> of line 7b, 10, or 11b. This is the most you can deduct. Add the amounts on lines 12a and 12b and enter the total on Form 1040, line 32. Or, if you want, you can deduct a smaller amount and treat the rest as a nondeductible contribution (see Form 8606)</p>	12a. <b>600.00</b>	12b.

Need more information or forms? See page 82.

- 30 -

## Line 51—Child Tax Credit

### Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit (see the instructions for line 6c).
- Step 2.** Make sure that for each qualifying child you either checked the box on Form 1040, line 6c, column (4), or completed Form 8901 (if the child is not your dependent).
- Step 3.** Answer the questions on this page to see if you can use the worksheet on page 40 to figure your credit or if you must use Pub. 972.

#### Questions

#### Who Must Use Pub. 972



1. Is the amount on Form 1040, line 38, more than the amount shown below for your filing status?
- Married filing jointly – \$110,000
  - Single, head of household, or qualifying widow(er) – \$75,000
  - Married filing separately – \$55,000
- ☐ **Yes.** You must use Pub. 972 to figure your credit.
- ☒ **No.** Go to question 2.

2. Are you claiming any of the following credits?
- Residential energy efficient property credit, Form 5695.
  - Retirement savings contributions credit, Form 8880.
  - Mortgage interest credit, Form 8396.
  - District of Columbia first-time homebuyer credit, Form 8859.
  - Adoption credit, Form 8839.

☒ **Yes.**

You must use Pub. 972 to figure your child tax credit. You will also need the form(s) listed above for any credit(s) you are claiming.

☐ **No.** Continue

3. Are you excluding income from Puerto Rico or are you filing any of the following forms?

- Form 2555 or 2555-EZ (relating to foreign earned income).
- Form 4563 (exclusion of income for residents of American Samoa).

☐ **Yes.**

You must use Pub. 972 to figure your credit.

☐ **No.** Use the worksheet on page 40 to figure your credit.

# Child Tax Credit Worksheet

Keep for Your Records

**Before you begin:** ✓ Figure the amount of residential energy efficient property credit, mortgage interest credit, or the District of Columbia first-time homebuyer credit you are claiming.



To be a qualifying child for the child tax credit, the child must be **under age 17** at the end of 2008 and meet the other requirements listed on page 2.



## Part 1

1. Number of qualifying children: 2 × \$1,000. Enter the result. **1** 2000
2. Enter the amount from Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36. **2** 27630
3. **1040 Filers.** Enter the total of any—
  - Exclusion of income from Puerto Rico; and
  - Amounts from Form 2555, lines 45 and 50; Form 2555-EZ, line 18; and Form 4563, line 15.**1040A and 1040NR Filers.** Enter -0-. **3** 0
4. Add lines 2 and 3. Enter the total. **4** 27630
5. Enter the amount shown below for your filing status.
  - Married filing jointly - \$110,000
  - Single, head of household, or qualifying widow(er) - \$75,000
  - Married filing separately - \$55,000**5** 75000
6. Is the amount on line 4 more than the amount on line 5?
 

☒ **No.** Leave line 6 blank. Enter -0- on line 7.

☐ **Yes.** Subtract line 5 from line 4.  
If the result is not a multiple of \$1,000, increase it to the next multiple of \$1,000.  
For example, increase \$425 to \$1,000, increase \$1,025 to \$2,000, etc.

**6**
7. Multiply the amount on line 6 by 5% (.05). Enter the result. **7** 0
8. Is the amount on line 1 more than the amount on line 7?
 

☐ **No.** You cannot take the child tax credit on Form 1040, line 51; Form 1040A, line 32; or Form 1040NR, line 46. You also cannot take the additional child tax credit on Form 1040, line 66; Form 1040A, line 41; or Form 1040NR, line 61. Complete the rest of your Form 1040, 1040A, or Form 1040NR.

☒ **Yes.** Subtract line 7 from line 1. Enter the result.  
*Go to Part 2 on the next page.*

**8** 2000

**Part 2**

9. Enter the amount from Form 1040, line 46, Form 1040A, line 28, or Form 1040NR, line 43.

9	913
---	-----

10. Add the amounts from—

**Form 1040 or Form 1040A or Form 1040NR**

Line 47	Line 29	Line 44	420
Line 48	Line 30		0
Line 49	Line 31		86
Line 50		Line 45	0
Line 53*		Line 48*	
Line 54**		Line 49**	
Enter the total.			10 506

\*Include only the amount(s), if any, from Form 5695, line 20, and Form 8396, line 13.

\*\*Include only the amounts, if any, from Form 8859, line 7.

11. Are you claiming any of the following credits?

- Retirement savings contribution credit, Form 8880
- Adoption credit, Form 8839

☐ **No.** Enter the amount from line 10.

☒ **Yes.** Complete the Line 11 Worksheet on the next page to figure the amount to enter here.

11	666
----	-----

12. Subtract line 11 from line 9. Enter the result.

12	247
----	-----

13. Is the amount on line 8 of this worksheet more than the amount on line 12?

☐ **No.** Enter the amount from line 8.

☒ **Yes.** Enter the amount from line 12. See the **TIP** below.

**This is your child tax credit.**

13	247
----	-----

Enter this amount on:  
 Form 1040, line 51;  
 Form 1040A, line 32;  
 or Form 1040NR, line 46.



You may be able to take the **additional child tax credit** on Form 1040, line 66; Form 1040A, line 41; or Form 1040NR, line 61 only if you answered "Yes" on line 13.

- First, complete your Form 1040 through line 65, Form 1040A through line 40a, or Form 1040NR through line 60.
- Then, use Form 8812 to figure any additional child tax credit.



## Line 11 Worksheet

Keep for Your Records

**Before you begin:** ✓ Complete the Earned Income Worksheet on page 8 or 9 that applies to you.

Use this worksheet only if you answered "Yes" on line 11 of the Child Tax Credit Worksheet on page 5.

1. Enter the amount from line 8 of the Child Tax Credit Worksheet on page 4.	1	2000
2. Enter your earned income from the worksheet on page 8 or 9 that applies to you.	2	28230
3. Is the amount on line 2 more than \$12,050?	3	16180
<input type="checkbox"/> <b>No.</b> Leave line 3 blank, enter -0- on line 4, and go to line 5. <input checked="" type="checkbox"/> <b>Yes.</b> Subtract \$12,050 from the amount on line 2. Enter the result.		
4. Multiply the amount on line 3 by 15% (.15) and enter the result.	4	2427
5. Is the amount on line 1 of the Child Tax Credit Worksheet on page 4 \$3,000 or more? <input checked="" type="checkbox"/> <b>No.</b> If line 4 above is: • Zero, enter the amount from line 1 above on line 12 of this worksheet. Do not complete the rest of this worksheet. Instead, go back to the Child Tax Credit Worksheet on page 5 and do the following. Enter the amount from line 10 on line 11, and complete lines 12 and 13. • More than zero, leave lines 6 through 9 blank, enter -0- on line 10, and go to line 11. <input type="checkbox"/> <b>Yes.</b> If line 4 above is equal to or more than line 1 above, leave lines 6 through 9 blank, enter -0- on line 10, and go to line 11. Otherwise, see <i>1040 filers</i> , <i>1040A filers</i> , and <i>1040NR filers</i> on page 7 and then go to line 6.		
6. Enter the total of the following amounts from Form(s) W-2: • Social security taxes from box 4, and • Medicare taxes from box 6. Railroad employees, see the bottom of page 7.	6	
7. <b>1040 filers.</b> Enter the total of any— • Amounts from Form 1040, lines 27 and 58, and • Any taxes that you identified using code "UT" and entered on the dotted line next to line 61. <b>1040A filers.</b> Enter -0-. <b>1040NR filers.</b> Enter the total of any— • Amount from Form 1040NR, line 53, and • Any taxes that you identified using code "UT" and entered on the dotted line next to line 57.	7	
8. Add lines 6 and 7. Enter the total.	8	
9. <b>1040 filers.</b> Enter the total of the amounts from Form 1040, lines 64a and 65. <b>1040A filers.</b> Enter the total of any— • Amount from Form 1040A, line 40a, and • Excess social security and tier 1 RRTA taxes withheld that you entered to the left of Form 1040A, line 43. <b>1040NR filers.</b> Enter the amount from Form 1040NR, line 60.	9	

If married filing jointly, include your spouse's amounts with yours when completing lines 6 and 7.

**Line 11 Worksheet—Continued from page 6**

**Keep for Your Records**

10. Subtract line 9 from line 8. If the result is zero or less, enter -0-. 10 0

11. Enter the **larger** of line 4 or line 10. 11 2427

12. Is the amount on line 11 of this worksheet more than the amount on line 1?  
☐ **No.** Subtract line 11 from line 1. Enter the result. 12 0  
☒ **Yes.** Enter -0-.

Next, figure the amount of any of the following credits that you are claiming.

- Retirement savings contributions credit, Form 8880
- Adoption credit, Form 8839

Then, go to line 13.

13. Enter the total of the amounts from—  
 • Form 8880, line 14, and  
 • Form 8839, line 18. 13 160

14. Enter the amount from line 10 of the Child Tax Credit Worksheet on page 5. 14 506

15. Add lines 13 and 14. Enter the total. 15 666

*Enter this amount on line 11 of the Child Tax Credit Worksheet on page 5.*

**1040 filers.** Complete lines 58, 64a, and 65 of your return if they apply to you.

**1040A filers.** Complete line 40a of your return if it applies to you. If you, or your spouse if filing jointly, had more than one employer for 2008 and total wages of over \$102,000 figure any excess social security and railroad retirement (RTA) taxes withheld. See the instructions for Form 1040A, line 43.

**1040NR filers.** Complete lines 53 and 60 of your return if they apply to you.

**Railroad employees.** Include the following taxes in the total on line 6 of the Line 11 Worksheet.

- ✓ Tier 1 tax withheld from your pay.  
This tax should be shown in box 14 of your Form(s) W-2 and identified as "Tier 1 tax."
- ✓ If you were an employee representative, 50% of the total Tier 1 tax and Tier 1 Medicare tax you paid for 2008.

# 1040 and 1040NR Filers - Earned Income Worksheet

Keep for Your Records



## Before you begin:

- ✓ Use this worksheet only if you were sent here from the Line 11 Worksheet on page 6 of this publication or line 4a of Form 8812, Additional Child Tax Credit.
- ✓ Disregard community property laws when figuring the amounts to enter on this worksheet.
- ✓ If married filing jointly, include your spouse's amounts with yours when completing this worksheet.

<p>1. a. Enter the amount from Form 1040, line 7, or Form 1040NR, line 8. . . . .</p> <p>b. Enter the amount of any nontaxable combat pay received. Also enter this amount on Form 8812, line 4b. This amount should be shown in Form(s) W-2, box 12, with code Q. . . . .</p> <p><b>Next</b>, if you are filing Schedule C, C-EZ, F, or SE, or you received a Schedule K-1 (Form 1065 or Form 1065-B), go to line 2a. Otherwise, skip lines 2a through 2e and go to line 3.</p> <p>2. a. Enter any statutory employee income reported on line 1 of Schedule C or C-EZ. . . . .</p> <p>b. Enter any net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1.* Reduce this amount by any unreimbursed nonfarm partnership expenses you deducted on Schedule E. <b>Do not</b> include any statutory employee income or any other amounts exempt from self-employment tax. Options and commodities dealers must add any gain or subtract any loss (in the normal course of dealing in or trading section 1256 contracts) from section 1256 contracts or related property. . . . .</p> <p>c. Enter any net farm profit or (loss) from Schedule F, line 36, and from farm partnerships, Schedule K-1 (Form 1065), box 14, code A.* Reduce this amount by any unreimbursed farm partnership expenses you deducted on Schedule E. <b>Do not</b> include any amounts exempt from self-employment tax. . . . .</p> <p>d. If you used the farm optional method to figure net earnings from self-employment, enter the amount from Schedule SE, Section B, line 15. Otherwise, skip this line and enter on line 2e the amount from line 2c. . . . .</p> <p>e. If line 2c is a profit, enter the <b>smaller</b> of line 2c or line 2d. If line 2c is a (loss), enter the (loss) from line 2c. . . . .</p> <p>3. Combine lines 1a, 1b, 2a, 2b, and 2e. If zero or less, <b>stop</b>. Do not complete the rest of this worksheet. Instead, enter -0- on line 2 of the Line 11 Worksheet on page 6 or line 4a of Form 8812, whichever applies. . . . .</p> <p>4. Enter any amount included on line 1a that is:</p> <p>a. A scholarship or fellowship grant not reported on Form W-2. . . . .</p> <p>b. For work done while an inmate in a penal institution (enter "PRI" and this amount on the dotted line next to line 7 of Form 1040 or line 8 of Form 1040NR). . . . .</p> <p>c. A pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (enter "DFC" and this amount on the dotted line next to line 7 of Form 1040 or line 8 of Form 1040NR). This amount may be shown in box 11 of your Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity. . . . .</p> <p>5. a. Enter any amount included on line 3 that is also included on Form 2555, line 43, or Form 2555-EZ, line 18. <b>Do not</b> include any amount that is also included on line 4a, 4b, or 4c above. . . . .</p> <p>b. Enter the amount, if any, from Form 2555, line 44, that is also deducted on Schedule C, C-EZ, or F, or included on Schedule E in partnership net income or (loss). . . . .</p> <p>c. Subtract line 5b from line 5a. . . . .</p> <p>6. Enter the amount from Form 1040, line 27. . . . .</p> <p>7. Add lines 4a through 4c, 5c, and 6. . . . .</p> <p>8. Subtract line 7 from line 3. . . . .</p>	<p>1a. <b>26000</b></p> <p>1b. <b>0</b></p> <p>2a. <b>0</b></p> <p>2b. <b>2400</b></p> <p>2c. <b>0</b></p> <p>2d. <b>0</b></p> <p>2e. <b>0</b></p> <p>3. <b>28400</b></p> <p>4a. <b>0</b></p> <p>4b. <b>0</b></p> <p>4c. <b>0</b></p> <p>5a. <b>0</b></p> <p>5b. <b>0</b></p> <p>5c. <b>0</b></p> <p>6. <b>170</b></p> <p>7. <b>170</b></p> <p>8. <b>28230</b></p>
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\*If you have any Schedule K-1 amounts and you are not required to file Schedule SE, complete the appropriate line(s) of Schedule SE, Section A. Put your name and social security number on Schedule SE and attach it to your return.



Form 1040—Lines 66a and 66b

## Lines 65a and 65b— Earned Income Credit (EIC)

### What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

### To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.

For help in determining if you are eligible for the EIC, go to [www.irs.gov/eitc](http://www.irs.gov/eitc) and click on "EITC Assistant." This service is available in English and Spanish.



*If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. See Form 8862, who must file, on page 47. You may also have to pay penalties.*

### Step 1 All Filers

1. If, in 2008:

- 2 children lived with you, is the amount on Form 1040, line 38, less than \$38,646 (\$41,646 if married filing jointly)?
- 1 child lived with you, is the amount on Form 1040, line 38, less than \$33,995 (\$36,995 if married filing jointly)?
- No children lived with you, is the amount on Form 1040, line 38, less than \$12,880 (\$15,880 if married filing jointly)?

☒ **Yes.** Continue →

☐ **No.** You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 47)?

☒ **Yes.** Continue →

☐ **No.** You cannot take the credit. Enter "No" on the dotted line next to line 65a.

3. Is your filing status married filing separately?

☐ **Yes.** You cannot take the credit.

☒ **No.** Go to question 4.

4. Are you filing Form 2555 or 2555-EZ (relating to foreign earned income)?

☐ **Yes.** You cannot take the credit.

☒ **No.** Continue →

5. Were you or your spouse a nonresident alien for any part of 2008?

☐ **Yes.** See *Nonresident aliens* on page 47.

☒ **No.** Go to Step 2.

### Step 2 Investment Income

1. Add the amounts from Form 1040:

Line 8a		
Line 8b	+	
Line 9a	+	
Line 13*	+	

Investment Income = 0

\*If line 13 is a loss, enter -0-.

2. Is your investment income more than \$2,950?

☐ **Yes.** Continue →

☒ **No.** Skip question 3; go to question 4.

3. Are you filing Form 4797 (relating to sales of business property)?

☐ **Yes.** See *Form 4797 filers* on page 47.

☐ **No.** You cannot take the credit.

4. Do any of the following apply for 2008?

- You are filing Schedule E.
  - You are reporting income from the rental of personal property not used in a trade or business.
  - You are reporting income on Form 1040, line 21, from Form 8814 (relating to election to report child's interest and dividends).
- ☐ **Yes.** You must use Worksheet 1 in Pub. 596 to see if you can take the credit.
- ☒ **No.** Go to Step 3.

Need more information or forms? See page 82.

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Continued from page 44

**Step 3 Qualifying Child****A qualifying child for the EIC is a child who is your...**

Son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your grandchild, niece, or nephew)

**AND**

was ...

Under age 19 at the end of 2008

or

Under age 24 at the end of 2008 and a student (see page 47)

or

Any age and permanently and totally disabled (see page 47)

**AND**

who...

Lived with you in the United States for more than half of 2008.

If the child did not live with you for the required time, see *Exception to time lived with you* on page 47.



**CAUTION** If the child meets the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2008, or the child was married, see page 47.

1. Do you have at least one child who meets the conditions to be your qualifying child?
- ☒ **Yes.** The child must have a valid social security number as defined on page 47 unless the child was born and died in 2008. Go to question 2.
- ☐ **No.** Skip question 2; go to Step 4.

2. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2008?

☐ **Yes.** You cannot take the credit. Enter "No" on the dotted line next to line 65a.☒ **No.** Skip Step 4; go to Step 5 on page 46.**Step 4 Filers Without a Qualifying Child**

1. Is the amount on Form 1040, line 38, less than \$12,880 (\$15,880 if married filing jointly)?
- ☐ **Yes.** Continue → ☐ **No.** You cannot take the credit.
2. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2008?
- ☐ **Yes.** You cannot take the credit. Enter "No" on the dotted line next to line 65a. ☐ **No.** Continue →
3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2008 tax return?
- ☐ **Yes.** You cannot take the credit. ☐ **No.** Continue →
4. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2008?
- ☐ **Yes.** Continue → ☐ **No.** You cannot take the credit.
5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2008? Members of the military stationed outside the United States, see page 47 before you answer.
- ☐ **Yes.** Go to Step 5 on page 46. ☐ **No.** You cannot take the credit. Enter "No" on the dotted line next to line 65a.

Continued from page 45

**Step 5 Earned Income**

1. Are you filing Schedule SE because you were a member of the clergy or you had church employee income of \$108,28 or more?

☐ **Yes.** See *Clergy or Church employees*, whichever applies, on this page. ☒ **No.** Continue

2. Figure earned income:

Form 1040, line 7 26,000

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- Amount received for work performed while an inmate in a penal institution (enter "PRI" and the amount subtracted on the dotted line next to Form 1040, line 7).
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (enter "DFC" and the amount subtracted on the dotted line next to Form 1040, line 7). This amount may be shown in box 11 of Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Add all of your nontaxable combat pay if you elect to include it in earned income. Also enter this amount on Form 1040, line 65b. See *Combat pay, nontaxable* on this page.



**Caution** Electing to include nontaxable combat pay may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election.

**Earned Income** = 26,000

3. Were you self-employed at any time in 2008, or are you filing Schedule SE because you were a member of the clergy or you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

☒ **Yes.** Skip question 4 and Step 6; go to Worksheet B on page 49. ☐ **No.** Continue

4. If you have:

- 2 or more qualifying children, is your earned income less than \$38,646 (\$41,646 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$33,995 (\$36,995 if married filing jointly)?
- No qualifying children, is your earned income less than \$12,880 (\$15,880 if married filing jointly)?

**Need more information or forms? See page 82.**

☐ **Yes.** Go to Step 6.

☐ **No.** **STOP**

You cannot take the credit.

**Step 6 How To Figure the Credit**

1. Do you want the IRS to figure the credit for you?

☐ **Yes.** See *Credit figured by the IRS* below. ☐ **No.** Go to Worksheet A on page 48.

**Definitions and Special Rules**

(listed in alphabetical order)

**Adopted child.** An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

**Church employees.** Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 5a. Subtract that amount from the amount on Form 1040, line 7, and enter the result in the first space of Step 5, line 2. Be sure to answer "Yes" to question 3 in Step 5.

**Clergy.** The following instructions apply to ministers, members of religious orders who have not taken a vow of poverty, and Christian Science practitioners. If you are filing Schedule SE and the amount on line 2 of that schedule includes an amount that was also reported on Form 1040, line 7:

1. Enter "Clergy" on the dotted line next to Form 1040, line 65a.
2. Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 2.
3. Subtract that amount from the amount on Form 1040, line 7. Enter the result in the first space of Step 5, line 2.
4. Be sure to answer "Yes" to question 3 in Step 5.

**Combat pay, nontaxable.** If you were a member of the U.S. Armed Forces who served in a combat zone, certain pay is excluded from your income. See *Combat Zone Exclusion* in Pub. 3. You can elect to include this pay in your earned income when figuring the EIC. The amount of your nontaxable combat pay should be shown in box 12 of Form(s) W-2 with code Q. If you are filing a joint return and both you and your spouse received nontaxable combat pay, you can each make your own election.

**Credit figured by the IRS.** To have the IRS figure your EIC:

1. Enter "EIC" on the dotted line next to Form 1040, line 65a.
2. Be sure you enter the nontaxable combat pay you elect to include in earned income on Form 1040, line 65b. See *Combat pay, nontaxable* above.
3. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, who must file on page 47.

**Exception to time lived with you.** A child is considered to have lived with you for all of 2008 if the child was born or died in 2008 and your home was this child's home for the entire time he or she was alive in 2008. Temporary absences by you or the child for special circumstances, such as school, vacation, business, medical care, military service, or detention in a juvenile facility, count as time the child lived with you. Also see *Kidnapped child* on page 17 or *Members of the military* below.

**Form 4797 filers.** If the amount on Form 1040, line 13, includes an amount from Form 4797, you must use Worksheet 1 in Pub. 596 to



**Worksheet B—Earned Income Credit (EIC)—Lines 65a and 65b**

Keep for Your Records



Use this worksheet if you answered "Yes" to Step 5, question 3, on page 46.

- ✓ Complete the parts below (Parts 1 through 3) that apply to you. Then, continue to Part 4.
- ✓ If you are married filing a joint return, include your spouse's amounts, if any, with yours to figure the amounts to enter in Parts 1 through 3.

**Part 1**
**Self-Employed,  
Members of the  
Clergy, and  
People With  
Church Employee  
Income Filing  
Schedule SE**

1a. Enter the amount from Schedule SE, Section A, line 3, or Section B, line 3, whichever applies.	1a	2,400
b. Enter any amount from Schedule SE, Section B, line 4b, and line 5a.	+ 1b	
c. Combine lines 1a and 1b.	= 1c	2,400
d. Enter the amount from Schedule SE, Section A, line 6, or Section B, line 13, whichever applies.	- 1d	170
e. Subtract line 1d from 1c.	= 1e	2,230

**Part 2**
**Self-Employed  
NOT Required  
To File  
Schedule SE**

For example, your net earnings from self-employment were less than \$400.

2. Do not include on these lines any statutory employee income; any net profit from services performed as a notary public, or any amount exempt from self-employment tax as the result of the filing and approval of Form 4029 or Form 4361.	
a. Enter any net farm profit or (loss) from Schedule F, line 36, and from farm partnerships, Schedule K-1 (Form 1065), box 14, code A*.	2a
b. Enter any net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1*.	+ 2b
c. Combine lines 2a and 2b.	= 2c

\*Reduce any Schedule K-1 amounts by any partnership section 179 expense deduction claimed, unreimbursed partnership expenses claimed, and depletion claimed on oil and gas properties. If you have any Schedule K-1 amounts, complete the appropriate line(s) of Schedule SE, Section A. Enter your name and social security number on Schedule SE and attach it to your return.

**Part 3**
**Statutory Employees  
Filing Schedule  
C or C-EZ**

3. Enter the amount from Schedule C, line 1, or Schedule C-EZ, line 1, that you are filing as a statutory employee.	3
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**Part 4**
**All Filers Using  
Worksheet B**

Note. If line 4b includes income on which you should have paid self-employment tax but did not, we may reduce your credit by the amount of self-employment tax not paid.

4a. Enter your earned income from Step 5 on page 46.	4a	26,000
b. Combine lines 1e, 2c, 3, and 4a. <b>This is your total earned income.</b>	4b	28,230

If line 4b is zero or less, You cannot take the credit. Enter "No" on the dotted line next to line 65a.

5. If you have:
- 2 or more qualifying children, is line 4b less than \$38,646 (\$41,646 if married filing jointly)?
  - 1 qualifying child, is line 4b less than \$33,995 (\$36,995 if married filing jointly)?
  - No qualifying children, is line 4b less than \$12,880 (\$15,880 if married filing jointly)?
- ☒ **Yes.** If you want the IRS to figure your credit, see page 46. If you want to figure the credit yourself, enter the amount from line 4b on line 6 (page 50).
- ☐ **No.** You cannot take the credit. Enter "No" on the dotted line next to line 65a.

**Part 5****All Filers Using Worksheet B**

6. Enter your total earned income from Part 4, line 4b, on page 49.

<b>6</b>	28,230
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7. Look up the amount on line 6 above in the EIC Table on pages 51–58 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

<b>7</b>	2,195
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If line 7 is zero,  You cannot take the credit. Enter "No" on the dotted line next to line 65a.

8. Enter the amount from Form 1040, line 38.

<b>8</b>	27,630
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9. Are the amounts on lines 8 and 6 the same?

☐ **Yes.** Skip line 10; enter the amount from line 7 on line 11.

☒ **No.** Go to line 10.

**Part 6****Filers Who Answered "No" on Line 9**

10. If you have:

- No qualifying children, is the amount on line 8 less than \$7,200 (\$10,200 if married filing jointly)?
- 1 or more qualifying children, is the amount on line 8 less than \$15,750 (\$18,750 if married filing jointly)?

☐ **Yes.** Leave line 10 blank; enter the amount from line 7 on line 11.

☒ **No.** Look up the amount on line 8 in the EIC Table on pages 51–58 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. Look at the amounts on lines 10 and 7. Then, enter the **smaller** amount on line 11.

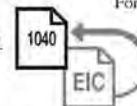
<b>10</b>	2,321
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**Part 7****Your Earned Income Credit**

**This is your earned income credit.**

**Reminder—**

- ✓ If you have a qualifying child, complete and attach Schedule EIC.



Enter this amount on Form 1040, line 65a.



If your EIC for a year after 1996 was reduced or disallowed, see page 47 to find out if you must file Form 8862 to take the credit for 2008.

<b>11</b>	2,195
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## Recovery Rebate Credit Worksheet—Line 70

Keep for Your Records



**Before you begin:** You cannot take the credit if you have no qualifying children for 2008 and received an economic stimulus payment of \$600 (\$1,200 if married filing jointly) before offset (see *Refund Offset* on page 59). You cannot take the credit because you already have received the maximum amount of the credit.

**TIP** If you received Notice 1378, have it available. The notice shows the amount of your economic stimulus payment, which you will need to fill in line 28 below.

1. Can you, or your spouse if filing a joint return, be claimed as a dependent on another person's return?
  - ☒ **No.** Go to line 2.
  - ☐ **Yes.** You cannot get the credit. **Stop** here.
2. Does your tax return include a valid social security number for you and, if filing a joint return, your spouse?
  - ☒ **Yes.** Skip lines 3 and 4 and go to line 5.
  - ☐ **No.** Go to line 3.
3. Are you filing a joint return for 2008?
  - ☐ **Yes.** Go to line 4.
  - ☐ **No.** You cannot take the credit. **Stop** here.
4. Were either you or your spouse a member of the U.S. Armed Forces at any time during 2008?
  - ☐ **Yes.** Go to line 5.
  - ☐ **No.** You cannot take the credit. **Stop** here.

**DRAFT**

5. Enter the amount from Form 1040, line 56 .....	5.	0
6. Enter the amount from Form 1040, line 51 .....	6.	247
7. Add lines 5 and 6 .....	7.	247
8. Enter \$600 (\$1,200 if married filing jointly) .....	8.	600
9. Enter the smaller of line 7 or line 8 .....	9.	247

Need more information or forms? See page 82.

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## Recovery Rebate Credit — Line 70 (continued)

10. Is the amount on line 9 at least \$300 (\$600 if married filing jointly)?		
<input type="checkbox"/> Yes.	If you have at least one qualifying child for whom you entered a valid social security number* on Form 1040, line 6c, column (2), and either checked the box on Form 1040, line 6c, column (4), or completed Form 8901, go to line 11. Otherwise, skip lines 11 through 21 and enter the amount from line 9 on line 22.	
<input checked="" type="checkbox"/> No.	If line 7 is more than zero, go to line 11. Otherwise, skip line 11 and go to line 12.	
11. Is your gross income** more than the amount shown below for your filing status?		
• Single or married filing separately — \$8,950		
• Married filing jointly — \$17,900		
• Head of household — \$11,500		
• Qualifying widow(er) — \$14,400		
<input type="checkbox"/> No.	Go to line 12.	
<input checked="" type="checkbox"/> Yes.	Skip lines 12 through 18 and go to line 19.	
12.	Enter the amount from Form 1040, line 20a	12. <input type="text"/>
13.	Enter the amount of any nontaxable veterans' disability or death benefits you received in 2008	13. <input type="text"/>
14. Are you filing Form 8812?		
<input type="checkbox"/> Yes.	Skip line 15. Enter on line 16 the amount from Form 8812, line 4a.	
<input type="checkbox"/> No.	Go to line 15.	
15. Are you filing Form 2555 or 2555-EZ to exclude foreign earned income, or using one of the optional methods to figure your net earnings from self-employment on Schedule SE, or are you a church employee or member of the clergy?		
<input type="checkbox"/> Yes.	Fill out the Earned Income Worksheet on page 8 of Pub. 972 and enter on line 16 the amount from line 8 of that worksheet.	
<input type="checkbox"/> No.	Go to line 16.	
16.	<b>Earned income.</b> If you did not already enter an amount on this line as instructed on line 14 or 15, complete Worksheet B on page 49 through line 4b. Enter the amount from Worksheet B, line 4b (If you had nontaxable combat pay, be sure to include it on this line even if you did not include it in earned income for the earned income credit. Also include it on Form 1040, line 64b)	16. <input type="text"/>
17.	<b>Qualifying income.</b> Add lines 12, 13, and 16	17. <input type="text"/>
18. Is line 17 at least \$3,000?		
<input type="checkbox"/> No.	Skip lines 19 through 21 and enter the amount from line 9 on line 22.	
<input type="checkbox"/> Yes.	Go to line 19.	
19.	Enter \$300 (\$600 if married filing jointly)	19. <input type="text"/> 300
20.	Enter the larger of line 9 or line 19	20. <input type="text"/> 300
21.	Multiply \$300 by the number of qualifying children for whom you entered a valid social security number* on Form 1040, line 6c, column (2), and either checked the box on Form 1040, line 6c, column (4), or completed Form 8901	21. <input type="text"/> 600
22.	Add lines 20 and 21	22. <input type="text"/> 900
23.	Enter the amount from Form 1040, line 38	23. <input type="text"/> 27,630
24.	Enter \$75,000 (\$150,000 if married filing jointly)	24. <input type="text"/> 75,000
25. Is the amount on line 23 more than the amount on line 24?		
<input checked="" type="checkbox"/> No.	Skip line 26. Enter the amount from line 22 on line 27 below.	
<input type="checkbox"/> Yes.	Subtract line 24 from line 23	25. <input type="text"/>
26.	Multiply line 25 by 5% (.05)	26. <input type="text"/>
27.	Subtract line 26 from line 22. If zero or less, enter -0-	27. <input type="text"/> 900
28.	Enter the amount, if any, of the economic stimulus payment you received (before offset) as shown on Notice 1378. If filing a joint return, include your spouse's payment. If you filed a joint return for 2007 and received an economic stimulus payment, you and your spouse are each treated as having received half of the payment	28. <input type="text"/> 600
29.	<b>Recovery rebate credit.</b> Subtract line 28 from line 27. If zero or less, enter -0-. Enter the result here and, if more than zero, on Form 1040, line 70. If you entered an amount on line 13 above, enter "VA" on the dotted line to the left of Form 1040, line 70. If line 28 is more than line 27, you do not have to pay back the difference	29. <input type="text"/> 300

\*A valid social security number is not required for a qualifying child if you filed a joint return AND either you or your spouse was a member of the U.S. Armed Forces at any time during 2008.

\*\*Your gross income includes the total of the following amounts: Form 1040, lines 7, 8a, 9a, 10, 11, 15b, 16b, 19, 20b, and 21 (excluding any negative amounts); Schedule C, line 7; Schedule C-EZ, line 1; Schedule E, lines 3 and 4; Schedule F, line 11; Form 4835, line 7; Schedule K-1 (Form 1065), box 14, codes B and C; Schedule K-1 (Form 1065-B), box 9, code K-2; Schedule K-1 (Form 1120S), box 14, code B. But do not include on this line any amount for which you claimed the foreign earned income exclusion or the housing exclusion on Form 2555 or 2555-EZ.

Your gross income also includes all gains from Schedule D, lines 1 and 8; Schedule D-1, lines 1 and 8; Form 4684, line 14, and column (c) of lines 29 and 34; Form 4797, lines 2, 10, and 30; Form 6252, lines 24 and 35; Form 6781, lines 1 and 12; Form 8824, lines 14, 23, 35, and 36; and Form 2439, line 1a. But subtract from this total any section 1202 exclusion, any section 1045 or section 1397B rollover, any exclusion of gain from DC Zone assets or qualified community assets, and any section 121 exclusion shown on Schedule D or Form 4797.



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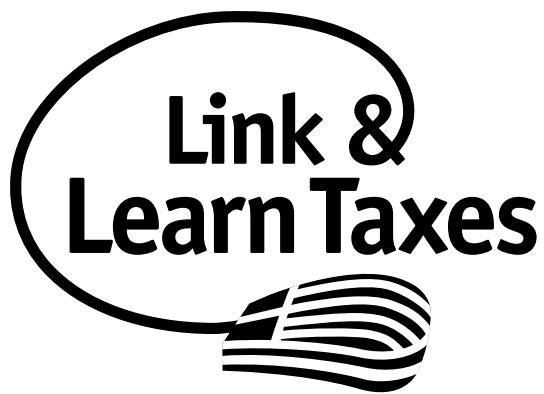
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